

Public Consultation – FUNC issue “Greater flexibility to book firm capacity at IPs”**Response submitted via an online form on 18.12.2021.**Section 1

The first version of the NC CAM of 2013 had been in place until the amended NC CAM came into force in April 2017 and repealed it. The NC CAM was implemented to address barriers to moving gas between Member States due to differences in capacity allocation methods and contractual congestion. The NC CAM introduced standard capacity products at IPs, bundling obligations and a common auction timetable to allow shippers to secure capacity on both sides of an IP. The NC CAM code has contributed to reduced contractual congestion, narrowing spreads and more liquidity across EU gas market.

This section contains questions aimed at identifying the degree of satisfaction regarding current capacity allocation mechanisms. It also aims at collecting the market need(s) for greater flexibility to book firm capacity at IPs, if any. You will be asked to evaluate the existing capacity allocation rules in the NC CAM and elaborate on which areas you feel need improvement or which areas are currently satisfactory to meet your needs. Your answers will be used to analyze if the current NC CAM limits opportunities for optimizing capacity allocation and improving market functioning.

For questions containing a scale from 1 to 5:

- 1 is to be considered as ‘not suitable to my current needs at all’
- 2 is to be considered as ‘somewhat suitable for my current needs’
- 3 is to be considered as ‘reasonably suitable for my current needs’
- 4 is to be considered as ‘highly suitable for my current needs’
- 5 is to be considered as ‘completely suitable for my current needs’

1. How do you generally evaluate the current rules for capacity allocation according to NC CAM regarding the design of the auction algorithms as defined in Articles 16-18 NC CAM?

- 1/2/3/4/5

1.1 Please elaborate on your rating

The auction algorithms in NC CAM are generally fit for purpose and have led to an improved efficiency of IP capacity booking within the EU. The ascending clock auction algorithm (ASC) successfully enables shippers to easily buy forward capacity to satisfy their supply obligations at the reserve price, and to effectively adjust their bid prices in light of any congestion. The uniform price auction algorithm (UPA) allows shippers to place spot capacity bids commensurate with their imbalance price risks, and to exploit spot arbitrage opportunities.

In the case of ASC auctions there have been cases where auctions have failed to close at congested IPs prior to, or very close to, the point where capacity becomes usable. There have also been cases where multiple bidding rounds occurred over a number of days but then collapsed failing to allocate much capacity, as the spreads changed suddenly making further

bidding uneconomic. Fortunately, such instances are rare, but it reinforces the need for TSOs to anticipate congestion and set large enough price steps between ASC auction rounds to minimise overly extended bidding periods.

1.2 Are you facing any specific problems with the current auction algorithms?

- Yes/No

1.2.2 If yes, please elaborate on how this could be improved:

N/A

1.4 How do you generally evaluate the current rules for capacity allocation according to NC CAM regarding the auction calendar as defined in Articles 11-15 NC CAM?

- 1/2/3/4/5

1.4.1 Please elaborate on your rating

The auction calendar, as defined in NC CAM and determined by ENTSOG, limits opportunities for arbitrage between EU gas markets to be fully exploited across the forward curve. At times when IP capacity is being auctioned profitable commodity arbitrage opportunities may not exist, whereas at times outside of NC CAM auction calendar they may do. Whilst arbitrage trades can be executed financially and unwound before delivery, making physical IP capacity unnecessary, and whilst some shippers may be willing to take the risk of executing commodity trades and booking capacity as an when available, arbitrage opportunities are still being missed, particularly in less liquid markets. Clearly we cannot go back to a “click and book” process, so an auction process and calendar are necessary to ensure transparency and consistency in capacity booking. However, the current rigidity of these is detrimental to market efficiency and reduces the opportunities for TSOs to sell capacity, potentially contributing to under recovery of TSOs’ allowed revenues.

The restrictions imposed by the auction calendar prevent shippers from fully capturing the intrinsic and extrinsic value of IP capacity. It was for this this reason that the two merchant TSOs that operate gas pipelines between the UK and the continent (IUK and BBL) chose to implement implicit capacity allocation mechanisms. These afford shippers more opportunities to exploit arbitrage (similar to what the EFET proposal is seeking achieve) and have been perceived to be quite successful, with significant quantities of capacity being sold when spreads are profitable (for example during this winter).

1.6 Are you facing any specific problems with the current auction calendar?

- Yes/No

1.5 How do you generally evaluate the current rules for capacity allocation according to NC CAM regarding auction calendar:

- 1/2/3/4/5

1.6.1 If yes, please elaborate on how this could be improved:

By implementing the EFET proposal.

2. Do the current runtimes of the standard capacity products provide sufficient flexibility to transport gas across the European Union? Please elaborate:

Yes, provided TSOs are able to anticipate congestion and set large enough price steps between ASC auction rounds, thereby avoid monthly auctions extending to the point where the first day-ahead UPA auction is due to take place for the month in question.

Also, booking platforms failures which result in NC CAM auctions being cancelled (particularly for day-ahead and within day IP capacity products) need to be kept to an absolute minimum, which has not always been the case.

2.1 Do the current runtimes of the standard capacity products still reflect the commercial need to exchange on commodity markets? Please elaborate:

Yes. Standard IP capacity products generally reflect the most liquid tenors in commodity markets.

3 Please provide any additional comments on the current capacity allocation rules and elaborate:

None

Section 2

This section contains questions aimed at collecting feedback on the proposal posted by EFET. We ask you to evaluate the EFET proposal based on your previously identified needs and consider whether the proposal would meet those needs in a satisfactory way. This will help us assess if the EFET proposal is a suitable solution for meeting the overall market needs.

EFET argues the current standard auction timetable still limits opportunities for arbitrage to be fully exploited, particularly across the forward curve. At times when capacity is being auctioned in accordance with the NC CAM, profitable commodity arbitrage opportunities may not exist, whereas at times outside of the NC CAM auction timetable they may do. EFET considers this to be detrimental to market efficiency and reduces the amount of IP capacity TSOs can sell.

The EFET proposal aims at making firm IP capacity more readily available to shippers by enabling TSOs to offer it for sale in uniform price allocation (UPA) auctions outside the CAM NC auction timetable dates. Supplementary UPA auctions for yearly, quarterly, and monthly IP capacity would be held for any capacity remaining unsold after the first relevant CAM NC (ascending clock) auction, up to the point where it becomes usable. Shippers would always have the option to bid for yearly, quarterly, and monthly IP capacity in the relevant CAM NC auctions first before any supplementary UPA auctions took place. To the extent an adjustment of implementation is not sufficient to accommodate the proposal, EFET proposes that a change to the CAM NC legal text as part of the 2021 EU Gas Legislative Package could be pursued.

For questions containing a scale from 1 to 5:

- 1 is to be considered as 'not appropriate at all'
- 2 is to be considered as 'somewhat appropriate'
- 3 is to be considered as 'reasonably appropriate'
- 4 is to be considered as 'highly appropriate'
- 5 is to be considered as 'completely appropriate'

4. Do you agree with the problem EFET has described in the posted FUNC issue?

- Yes/No

4.1 Please elaborate on your answer:

There are plenty of examples of profitable price spreads existing between EU markets both before and after the point where it is currently possible to acquire IP capacity under NC CAM, and where price spreads do not support arbitrage at the point when auctions are actually held.

5. Do you consider the EFET proposal to introduce a supplementary uniform price allocation (UPA) auctions, for yearly, quarterly and monthly products, to be an appropriate improvement to the current system of allocation of capacities according to the CAM NC?

- 1/2/3/4/5

5.1 Please elaborate on your rating

The EFET proposal strikes an appropriate balance between maintaining the primacy and integrity of the now established NC CAM auction processes and calendar and allowing for IP capacity to be offered more flexibly. Capacity is purchased by shippers who have different risk appetites and motivations. The ASC auctions for yearly, quarterly and monthly capacity provide shippers with an efficient method of booking capacity to meet known supply and portfolio commitments. The UPA auctions for day-ahead and within day capacity allow

shippers to dynamically book capacity to respond to spot market arbitrage opportunities and to adjust their imbalance positions. Extending UPA auctions to yearly, quarterly and monthly capacity bookings will bring this same dynamism to forward markets, but only after those shippers who buy capacity to meet known supply and portfolio commitments have first been able to acquire it in an ASC auction, in exactly the same way as they do now.

6. Do you consider the EFET proposal to introduce more than one opportunity per month to book monthly capacity products (via UPA) to be an appropriate improvement to the current system of allocation of capacities according to the CAM NC?

- 1/2/3/4/5

6.1 Please elaborate on your rating

Monthly IP capacity is perhaps the most appealing for arbitrage purposes, because the front month tends to be the most liquid tenor in commodity forward markets, even in those which are less developed. Monthly products also require less collateral to be posted vis-à-vis the commodity and capacity cost, so making it more readily available benefits small shippers as well as large ones.

7. Do you consider the EFET proposal to increase the opportunities to book quarterly capacity products (via UPA) to be an appropriate improvement to the current system of allocation of capacities according to the CAM NC?

- 1/2/3/4/5

7.1 Please elaborate on your rating

Quarterly IP capacity is also appealing for arbitrage purposes and can also be used to underpin seasonally related flows, e.g. for cross-border use of storage.

8. Do you consider the EFET proposal to increase the opportunities to book yearly capacity products (via UPA) to be an appropriate improvement to the current system of allocation of capacities according to the CAM NC?

- 1/2/3/4/5

8.1 Please elaborate on your rating

Of all the IP capacity products EFET proposes to make available via supplementary UPA auctions yearly capacity is perhaps the least essential. This is because yearly arbitrage opportunities are less frequent and more costly in terms of collateral. Also, the period of time

between front (gas) year capacity being first offered in July and it being available to purchase in supplementary UPA allocation auctions thereafter is relatively short compared to its duration. Nevertheless, affording shippers the opportunity to book front year capacity much closer to the point where it becomes usable may help shippers who have yearly supply and portfolio commitments over this period. These commitments may not be fully clear in July when the ASC auction takes place.

9. Would you agree with EFET that additional auctions should be a voluntary option for TSOs or not?

- Voluntary/Mandatory

9.1. Please explain your reasoning:

In an ideal world, additional UPA auctions should clearly be mandatory and applied at all EU IPs. However, when raising the proposal we anticipated there may be resistance to it from some less forward looking TSOs and booking platforms, along with negative criticism about the time and cost involved in implementing the proposal for “dubious” or unquantified benefits. As such, we suggested the proposal should be pursued on voluntary basis as we thought there would be many TSOs that realised the benefits of allowing shippers more opportunities to book IP capacity (as IUK and BBL have demonstrated). If the proposal could be implemented quickly (possibly even without having to change NC CAM) this would create the necessary momentum for others to follow suit.

However, depending on the responses to this consultation we could be persuaded that a mandatory approach is preferable and able to deliver the same results more effectively and as quickly. This would be the optimal outcome, but adopting a mandatory approach should not become the basis for TSOs or booking platforms being able to water down the proposal or drag it out indefinitely if a voluntary approach could be delivered quickly and effectively.

10. In case any additional auctions would be implemented on a voluntary basis, how can we assure that the bundling principle is followed? Please elaborate:

The bundling principle applies to allocation only, as IP capacity bookings remain as separate entry and exit capacity contracts with the individual TSOs either side of an IP. As such, implementing the EFET proposal on a voluntary basis does not change this principle, as the capacity booking platforms will still take all the available capacity TSOs notify them about and match this at IPs (based on the “lesser of rule”) to auction bundled capacity products.

Conceivably, implementing the proposal on a voluntary basis may mean more unbundled capacity is offered at certain IPs should some TSOs or booking platforms refuse to implement it. However, in time we expect all TSOs and booking platforms to see the benefits of the proposal, and unbundled capacity is unlikely to be bought if a shipper does not have, or cannot acquire, unbundled capacity at the other side of an IP. As any capacity offered by a TSO or booking platform not prepared to implement the EFET proposal will always be bundled to the

maximum extent possible (as now), we do not think the bundling principle will realistically be undermined.

11. What are, from your point of view, the positive aspects of the supplementary uniform price allocation (UPA) auctions for yearly, quarterly, and monthly IP capacity proposed by EFET, as compared to the current CAM NC rules on capacity allocation? Please elaborate:

Supplementary UPA auctions for yearly, quarterly and monthly IP capacity will provide more opportunities for arbitrage trades to be executed along the gas forward curve, thereby narrowing price spreads between EU gas markets and reinforcing price correlation. This will also generate more capacity sales, which reduces the risk of TSOs under recovering their allowed revenues.

12. What are, from your point of view, the negative aspects with the supplementary uniform price allocation (UPA) auctions for yearly, quarterly, and monthly IP capacity proposed by EFET, as compared to the current CAM NC rules on capacity allocation? Please elaborate:

Adding supplementary UPA auctions for yearly, quarterly and monthly IP capacity will increase the complexity of the auction calendar and require shippers to adapt their booking operations. However, we see this as a necessary step to enable shippers to take advantage of the new opportunities afforded to them, not as a negative one.

Going forward, ENTSOG is expected to change the common data exchange solutions table (CNOT) to require document-based exchange for IP capacity interactions between shippers and capacity booking platforms, as part of the solution to FUNC request 3/2019. This should facilitate more efficient capacity booking and make it easier for shippers to submit supplementary UPA auction bids within the relatively tight booking windows proposed by EFET each business day. Whilst supplementary UPA auctions may require ENTSOG and Edigas to make changes to the capacity booking business requirements specification (BRS) and Edigas file formats, we expect these to be minor and easily deliverable.

13. Which elements of the EFET proposal may be advantageous for your company and why? Please elaborate:

We cannot speak for any of our members, but EFET would not have raised the proposal without the support of its members, the majority of whom identify the significant advantages it will bring to their trading activities.

14. Which elements of the EFET proposal may be disadvantageous for your company and why? If you have any, please include suggestions to improvements of the proposal. Please elaborate:

The proposal was deliberately structured in such a way as to avoid any obvious disadvantages for EFETs' members, or for EU gas markets in general.

Section 3

This section contains questions aimed at exploring other options to increase flexibility in capacity bookings, besides the EFET proposal. If you previously indicated a need for change in the current capacity allocation rules, and identified problems with the EFET proposal, this section would allow you to propose alternative ways to meet your needs.

15. What other runtimes of the standard capacity products would be desirable from a market perspective? (multiple answers are possible)

- Season/**Balance of month/Weekend**/Other/No other products are desirable

15.1 Please specify, if other:

N/A

15.2 Please elaborate on why these products are desirable or not desirable:

Whilst our proposal was based around the standard IP capacity products in NC CAM, we do see merit in introducing runtimes for new BOM and weekend IP capacity products, provided these can be readily integrated into the existing auction calendar in or treated as supplementary UPA auctions and providing they do not undermine day-ahead auctions, which are important for balancing.

To this extent it might be possible to hold a one-off UPA auction for weekend capacity on Friday at the same time as the current NC CAM day-ahead auction, with Saturday being treated as a competing auction. UPA auctions for a BOM product could also perhaps be held at the same time as monthly UPA auctions, for capacity from D+2 to the end of the month. Notwithstanding the need to consider public holidays as well, this would better align actively traded commodity products with equivalent IP capacity bookings.

16. Would you see merit in offering capacity further in advance of delivery to provide more opportunities to book capacity products compared to the current auction calendar? For example, for the monthly products, instead of the current rule that each month, the monthly standard capacity product for the following calendar month shall be auctioned, this could be extended further into the future to cover multiple months ahead.

- Yes/**No**

17. If yes, which products would you like to be able to book/offer further in advance?

N/A

17.1 Please elaborate, if other:

N/A

17.2 Please elaborate on your answer and indicate how much further in advance each product would be desired to be booked/offered.

There could be merit in allowing quarterly products to be bookable up to two gas years out (rather one gas year out at present) and for monthly products to be bookable up to three months out (rather than one month out at present). However, whilst this would further enhance arbitrage opportunities along the forward curve it would conflict with the cascading principle enshrined within NC CAM. So, for example, in October it would be possible to buy January IP capacity which forms part of the Q1 capacity product first offered in November. Consequently, any unsold yearly capacity would not first be made available as quarterly capacity and unsold quarterly capacity would not first be made available as front month capacity. Also day-ahead and within day capacity could be less readily available if they have previously been reserved as part of further out quarterly and monthly capacity products.

Allowing existing NC CAM products to be booked further out would also make implementing the EFET proposal far more complicated. So, on balance, we prefer the benefits arising from the EFET proposal over extending the forward booking capability of quarterly and monthly products.

18. Would you see a merit in exploring the potential for a wider use of implicit allocation methods (as defined in Article 3 NC CAM) for allocation of capacities?

- Yes/No

18.1 Please elaborate on your answer and if possible, provide suggestions for how implicit allocation methods could be further developed.

Implicit allocation in electricity markets arose as consequence of cross-border physical congestion, TSOs unwillingness to embrace forward capacity allocation (which persists to this day) and because of the inability to achieve efficient price arbitrage between low and high priced interconnected markets in an instantaneous system balancing environment. As a day-ahead and intraday capacity allocation method it has proved effective in eliminating price inefficient cross-border electricity flows and concentrating liquidity in the spot trading tenor. However, gas flows at a far slower and controllable speed and can be stored in the system as linepack. So gas is explicitly scheduled to flow in the spot trading tenor and short, medium and long-term IP capacity is visible and readily offered, with any congestion typically being contractual rather than physical.

Moving towards, or even considering, widescale implicit allocation methods for short, medium or long-term IP capacity in EU gas markets would be a massive and unnecessary distraction at this stage, for little added benefit. Attempting to efficiently integrate the IP capacity currently offered by multiple TSOs, across three separate booking platforms, with the order books of

multiple gas exchanges, trading platforms and brokers would take years to develop. And by the time it could likely be implemented gas usage is likely to be in decline, due to increasing decarbonisation.

IUK and BBL have been able to implement their own forms of implicit allocation with some success. But this is still only with a limited number of broker partners and the criteria for matching capacity with commodity trades is very wide. The challenge of replicating this across the EU for non-merchant TSOs' IP capacity should not be underestimated and the additional complexity that comes with allocating available capacity to a number of implicit allocation partners makes their product offerings less straightforward and more fragmented, reducing accessibility and visibility for some market participants.

The benefits implicit allocation could theoretically deliver could be achieved far more effectively and quickly instead by adapting the current explicit allocation process, as described in EFET proposal.

19. Do you have any alternative proposals on how to improve the current offer of capacity products and the rules on capacity allocation? Please elaborate:

Consideration could be given to pushing back the timeslot of the day-ahead NC CAM auctions so that they close nearer the end of trading window, particularly if this alleviates any time pressures resulting from introducing new supplementary UPA auctions.

20. What other concrete changes, within the scope of the current FUNC issue, could improve the access to transmission capacity and contribute to better cross-border competition and market integration? Please elaborate:

If the EFET proposal is not acceptable to policymakers or regulators, steps should be taken to implement an approach which allows for quarterly products to be bookable up to two gas years out and monthly products to be bookable up to three months out. However, as stated in our response to question 17.2, whilst this could have benefits we do not think these will be as great as the benefits arising from the EFET proposal, and the implementation costs and resources are likely to be similar under both approaches.