EuroPEX
Association of European Power Exchanges

Position Paper on Gas Balancing

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I. Executive Summary

EuroPEX advocates the development of integrated, liquid and efficient wholesale markets for gas in Europe and considers **market-based balancing** rules as a corner stone of this objective. The current patchwork of balancing rules and mechanisms across Europe hampers cross border gas trading and as such impedes the **development of liquid, integrated (spot) markets**. Therefore EuroPEX strongly supports the **development of a European framework** aimed at developing harmonized balancing rules and market based balancing mechanisms between adjacent market areas or member states. Market based daily balancing should be the **target model** for Europe. Mindful of the importance of balancing rules for the realization of Europe's vision of a single integrated gas market, EuroPEX considers it of key importance that a set of binding **transitional arrangements** is developed, aimed at implementing the target model. Energy exchanges have significant experience in **operating balancing markets** and can therefore qualified to assist in the development and implementation of market based daily balancing regimes.

II. Introduction

This note contains the position of EuroPEX with regards to the development of framework guidelines and network codes for gas balancing in the context of the third European legislative package for the energy markets. Regulation (EC) No 715/2009 on conditions for access to the natural gas transmission networks states that the European Commission shall request the Agency for the Cooperation of Energy Regulators ("ACER") to submit framework guidelines setting out clear and objective principles for the development of network codes relating to inter alia gas balancing. These framework guidelines shall contribute to non-discrimination, effective competition and the efficient functioning of the market. Thereafter the European Commission shall request the European Network of Transmission System Operators for Gas ("ENTSO-G") to submit a network code on gas balancing which is in line with the relevant framework guideline to ACER. EuroPEX welcomes the timely efforts of the European Regulators' Group for Electricity and Gas ("ERGEG") by developing the framework guidelines for balancing in advance of ACER becoming fully operational.

A network code relating to Gas balancing is of interest to EuroPEX because it is an important part of network access and can put up barriers for new market entrants. Moreover the absence of harmonized balancing rules and market based balancing mechanisms between adjacent market areas or member states hampers cross border gas trading and as such impedes the development of liquid, integrated (spot) markets. As EuroPEX is committed to the objective of creating more transparent, efficient, liquid and integrated European gas markets it deems harmonized and market-based gas balancing rules a prerequisite for further work towards this objective.

Below the basic conditions of a market-based balancing regime are outlined (target model). This is followed by EuroPEX' view on the role of exchanges. Finally we address the need for a transitional arrangement that allows for the development from the current situation towards the target model.

III. Target model: Market Based Daily Balancing

EuroPEX advocates the development of integrated, liquid and efficient wholesale markets for gas and considers market-based balancing rules as a corner stone of this objective. According to us a market-based daily balancing regime must satisfy the following four basic conditions:

1. Network users shall be primary responsible for balancing their portfolios and must be able to redress deviations between their system inputs and off-takes by buying or selling gas on a spot market (either day ahead and/or intra-day). Therefore network users shall have access to accurate, near-real-time information with regards to the balancing status of their portfolios, and

2. Network users shall be allowed to assist the TSO in restoring system balance by buying or selling gas on a spot market (either day ahead and/or intra-day). Therefore network users shall have access to accurate, near-real-time information with regards to the balancing status of the system and

3. The TSO is ultimately responsible for maintaining the overall network integrity and shall redress residual network imbalances by buying or selling gas on a spot market (either day ahead and/or intra-day) as soon as a pre-determined system-balance limit is breached. All balancing actions taken by the TSO on the spot market shall be published immediately and are to made subject to oversight by the relevant National Regulator and

4. The volume and marginal price at which a TSO buys or sells gas on a spot market (either day ahead and/or intra-day) to restore system balance forms the basis for the settlement of imbalances between the TSO and network users. In case the TSO has not taken any balancing actions by buying or selling gas on the spot market the volume weighted average price of all transactions concluded on the spot market will serve as the basis for the cash out price against which imbalances are settled between the TSO and network users.

EuroPEX prefers a balancing period of one day[1] (daily balancing) which should be characterized by a settlement procedure at the end of that day. A balancing period of one day is preferable to a sub-daily or hourly balancing period because a market for daily products or end-of-day products (used in daily balancing) is more likely to become sufficiently liquid than a market for (multi-)hourly blocks. This means that TSOs and

[1] Actually, there are different definitions of gas-day within Europe: most European countries have gas day starting from 6 a.m., while in some Eastern countries gas-day starts from 8 a.m. (in Poland gas day starts from 10 p.m.). For market purposes, it is necessary to have an unified definition of the gas day. EuroPEX proposes to adopt within Europe a gas-day starting from 6 a.m., as it is in most European countries.

network users are both less exposed to market risks in a daily balancing regime which allows them with better opportunities to take balancing actions. The advantage of having a balancing period of one day is especially relevant to network users active in markets where there is little (physical) flexibility available or the market for (physical) flexibility is highly concentrated. Although the operational capabilities of a transportation system are an important factor to take into account when implementing the target model, a decision to use a shorter balancing period (whether hourly or sub-daily) may only be taken to ensure that the system can be safely balanced and operated. Such a decision should be substantiated by the TSO and requires prior approval from the National Regulator after consultation of network users.

Information transparency is an important element of a well functioning market based balancing regime. Therefore TSOs shall be responsible to ensure that network users have equal access to accurate, near-real-time information with regards to the balancing status of their portfolios and the transportation system. EuroPEX notes that bodies, independent from stakeholders where such information is derived, should be qualified to coordinate, support and publish information relating to the balancing regime (e.g. buying or selling gas by the TSO from network users, settlement prices, etc.). Such neutral bodies should include energy exchanges as they have the natural interest and competence to facilitate the accessibility of such information. Moreover energy exchanges are independent from market participants and TSOs because they do not have direct commercial interest in this type of information. In addition, their activities are internally supervised and typically subject to oversight by sectoral or financial regulatory entities.

A daily balancing regime that satisfies the above mentioned conditions is market-based because the outright price for gas results from the reconciliation of supply and demand of/for gas on an spot market (intraday or day ahead). Since a TSO uses the same market to buy and sell gas in order to maintain system balance, the resulting imbalance costs will be in line with the market (hence cost reflective).

IV. Role of exchanges

Energy Exchanges have shown in the past their ability to design, implement and operate (balancing) markets in a highly professional manner and in accordance with the needs of the market participants and TSOs. Therefore EuroPEX is keen on playing a vital role in the discussion on framework guidelines and network codes for gas balancing and looks forward to providing assistance in the development, implementation and operation of balancing regimes. Below we provide our view on the role of exchanges.

The role of an exchange is to:

- Provide a centrally cleared and liquid trading market for network users and TSOs,
- Perform the role of Central Counter Party (CCP) which protects TSOs and network users from counterparty risk, enables an efficient settlement process of imbalance charges and ensure the anonymity of market parties,
- Ensure a fair and orderly market process trough transparent and non-discriminatory market rules, subject to oversight of national regulators,
- Reduce entry barriers by applying transparent and non-discriminatory accession rules,
- Provide timely and relevant information relating to prices, volumes, indices (settlement prices) and balancing actions taken by the TSO whilst preserving the anonymity of market parties,
- Support TSOs and network users in implementing processes and products which are in line with market principles, with particular focus on the design of rules balancing actions by TSOs.

V. Binding transitional arrangements

As stated above EuroPEX considers market-based daily balancing a corner stone of the development of integrated, liquid and efficient wholesale markets for gas. Despite recent improvements in some countries (e.g. France and Germany) the current situation in Europe can still be characterized as a patchwork of different national and regional balancing regimes. Most of these are sub-daily where balancing energy is procured on a long term bases (in stead of intra-day or day ahead). None of the existing balancing regimes seems to be designed with the aim of harmonizing balancing rules between neighbouring TSOs (as much as possible). In some cases the opportunity for harmonizing of balancing rules by applying the Guidelines of Good Practice for Gas Balancing (GGPGB) of ERGEG have been missed because TSOs and national regulators decided not to comply with these guidelines during the development of a new balancing regime (e.g. the Netherlands).

Mindful of these experiences and the importance of balancing rules for the realization of Europe's vision of a single integrated gas market, EuroPEX considers it of key importance that a set of *binding* transitional arrangements is developed, aimed at developing the current situation into the desired end state. Where balancing regimes are different between interconnected networks, a report shall be produced by the TSOs identifying the key areas of difference and their impact, including on trade and the efficient operation of the market. In addition, an action plan shall be produced by the TSOs to identify the development of measures to ensure the target model is implemented. The report and action plan shall be published following open consultation with all market participants and approved by the national regulators[2].

Special consideration should be given to the argument that it is dangerous to introduce a market based balancing regime at a time when the traded market is not yet sufficiently liquid. This problem is often solved by allowing the TSO to set up a separate balancing market from the traded market. By doing so the traded market runs the risk of never becoming liquid enough because the TSO's balancing market does. This problem of splitting liquidity between two markets has been observed in the electricity market before (so called the 'liquidity trap'). Moreover, EuroPEX is doubtful that setting up a completely new balancing market by the TSO (with no liquidity at all) is an appropriate response to the lack of liquidity of the traded market. Several solution are available to prevent falling into this liquidity trap (market making, liquidity providers, physical and locational products, etc.) which should play an important role in designing both the target model as well as the transitional arrangements.

[2] Based on Guidelines of Good Practice for Gas Balancing (GGPGB), ERGEG, 6 December 2006.