

EuroPEX Response to ERGEG public consultation
on
Draft Framework Guideline on Gas Balancing

25 October 2010

Table of Contents

I. Introduction	3
II Problem Identification and Policy Objectives	4
III Proposed Pilot Framework Guideline and Initial Impact Assessment.....	6
<i>Role of network users and TSOs & TSO obligations on information provision</i>	<i>6</i>
<i>Balancing periods</i>	<i>7</i>
<i>TSO buying and selling of flexible gas & procurement of balancing services</i>	<i>8</i>
<i>Imbalance charges for system users</i>	<i>10</i>
<i>TSO cross border cooperation.....</i>	<i>10</i>

I. Introduction

1. EuroPEX appreciates the efforts of ERGEG and the expert group in drafting the framework guideline on gas balancing and the accompanying initial impact assessment and welcomes the opportunity to provide its views on the draft framework guideline.
2. This note contains the response of EuroPEX to the public consultation of the draft framework guideline on gas balancing. It builds on our position paper on gas balancing¹ and the joint position on gas balancing as presented by 7 associations of network users at the 18th meeting of the European Gas Regulatory Forum (Madrid Forum)². In the first part, this note contains our view on the current problems in relation to gas balancing and the policy goals. The second part provides EuroPEX' position on each of the elements of the draft framework guideline on gas balancing and the initial impact assessment.
3. Gas balancing rules are an important part of network access which can create barriers for new entrants to the wholesale market for gas. 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 the framework guideline provides the principles for the development of network codes on gas balancing, it is of interest to our members.
4. Our members are strong supporters and enablers of gas market development and integration, and look forward to applying their skills and experience with the aim of creating transparent, efficient, liquid and integrated European gas markets. In our view, harmonized and market-based gas balancing rules are a prerequisite for further work towards this objective.

¹ EuroPEX, "Position paper on gas balancing", 1 September 2010. [<http://www.europex.org/default.asp?kaj=news&id=302>]

² Eurelectric, Geode, Eurogas, EuroPex, CEDEC, OGP and EFET, "COMMON POSITION ON GAS BALANCING RULES", 24 September 2010. [http://ec.europa.eu/energy/gas_electricity/forum_gas_madrid_en.htm]

II Problem Identification and Policy Objectives

5. EuroPEX agrees with the problem identification and policy objectives of ERGEG as they coincide with the interests and objectives of our members. Moreover, we agree with the implications of these goals in terms of market based balancing but would like to stress that market based balancing does require TSOs to buy and sell gas on a common market for wholesale and balancing gas and on an equal footing with network users.
6. The approach of ERGEG to set forth principles and objectives of a target model is according to EuroPEX the best way to harmonize balancing regimes across Europe. The proposal to take interim steps which lead to the target model is useful in light of the differences between (national) balancing regimes and the different stages of development of wholesale markets on national or regional level.
7. In spite of our agreement on the proposed approach and key principles of the target model, EuroPEX is of the opinion that the draft framework guideline currently lacks the clarity and level of detail needed to ensure that the target model will eventually be implemented. Our concerns mainly focus on (i) the absence of binding transitional arrangements and (ii) the use of the notion of liquidity of wholesale markets as the sole relevant metric.
8. The approach whereby interim steps should lead to the implementation of the target model is at present noncommittal because the draft framework guideline does not prescribe how and when the interim steps should be taken. Therefore EuroPEX proposes to include in the draft framework guideline the obligations on TSOs as set forth in ERGEG's Guidelines of Good Practice for Gas Balancing. 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 action plan shall include a detailed planning which ensures the implementation of the target model within 3 years after the network codes have come into force. The report and the action plan shall be published following open consultation with all market participants and approved by the national regulator³.

³ Based on Guidelines of Good Practice for Gas Balancing (GGPGB), ERGEG, 6 December 2006.

9. The draft framework guideline does not provide clear guidance as to when it is necessary to take interim steps and when it is possible to implement (parts of) the target model immediately. This is to a large extent due to the use of the notion of ‘wholesale market liquidity’. EuroPEX notes the importance of this notion in the framework guideline as it is a key criterion for taking a decision on almost all of the main balancing rules of the target model. Although we agree that the liquidity of the wholesale market should be taken into consideration, it is almost impossible to use this notion as (objective) criterion for these decisions. More precisely, it is almost impossible to assess whether or not the wholesale market is *sufficiently* liquid to allow network users to buy and sell gas to balance their portfolios and for the TSOs to fulfil their residual balancing role. Moreover the strong emphasis on liquidity in the draft framework guideline passes over the fact that existing balancing regimes are often the main cause of the lack of liquidity of the market for flexible gas. Instead of looking at the current level of liquidity, EuroPEX suggests that the framework guideline should state that decisions on whether or not to introduce the target model, should take the future development of the liquidity of the market for flexible gas as a starting point. One way of doing this is to focus on the structure of the market for flexible gas (instead of the liquidity of the traded market) by looking at the size of the market in relation to the need for flexibility and the level of market concentration (e.g. HHI).
10. These concerns can be illustrated by looking at the new balancing regime in the Netherlands. The Dutch system operator is currently implementing a cumulative balancing system with hourly constraints in which the TSO buys or sells physical gas (as opposed to the virtual gas hub, the ‘Title Transfer Facility (TTF)’) to balance the network on a separate balancing platform. The decision to create a separate balancing platform was taken on the basis of the insufficient liquidity⁴ of the short term flexible gas market on the TTF. Although this decision has been supported by most stakeholders in the Netherlands, it provides a striking example of the use of the notion of liquidity if one takes into consideration that the TTF is the most liquid trading hub in Europe after the NBP (UK). This leads us to doubt whether the target model is achievable in the medium term given the liquidity of other gas hubs in Europe.
11. In light of the importance of the liquidity of the wholesale market, EuroPEX proposes to include the notion of liquidity in the list of definitions of the framework guideline. Additionally we suggest adding to the definition the aspects for assessing the level of

⁴ In 2009 a total of 142 TWh was traded on the TTF within-day and day-ahead market.

liquidity (churn rate, traded volume, number of trades, number of active buyers/sellers, market depth, volatility, level of price transparency and bid/offer spread).

III Proposed Pilot Framework Guideline and Initial Impact Assessment

Role of network users and TSOs & TSO obligations on information provision

12. According to EuroPEX' position paper on gas balancing the role of network users and TSOs in a market-based daily balancing regime should be as following:

- 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
- 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
- TSOs are 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

13. In our view the option to allow network users to balance without 'within-day constraints' is to be preferred. In situations where the available line pack would put the system outside of its safe operational limits, 'within-day constraints' could be considered as long as they apply to all network users on an equal footing. Although this policy option is recommended by ERGEG, we would like to suggest including this in the target model and interim steps (Ad 5.A. and 5.B.).

14. 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.
15. Regarding the article 4.5. of the draft framework guideline, EuroPEX suggests that TSOs should provide information regarding the overall status of the system (amount of gas in the transmission system at the start of each gas day and the forecast of the amount of gas in the transmission system at the end of each gas day), instead of the aggregated imbalance position of all users. The reason is that TSOs may not have a timely and complete availability of information regarding imbalances of every market participants. Moreover, a forecast by TSOs about the aggregated imbalance position of all users could give room to potential abuse by network users.

Balancing periods

16. EuroPEX supports the target model; a balancing period of one day⁵ (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 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.
17. As the operational capabilities of a transportation system are an important factor to take into account when implementing the target model, we prefer the introduction of intra-day restrictions over a shorter balancing period as an interim step. As a last resort shorter balancing may be considered to ensure that the system can be safely balanced and operated. As regards the latter, EuroPEX prefers a balancing period of the least number

⁵ EuroPEX proposes to adopt within Europe a gas-day from 6 A.M to 6 A.M. (CET, GMT+1)

of blocks, each of which has the maximum number of hours (e.g. 2 blocks of 12 hours, 3 blocks of 8 hours, etc). A decision by the TSO to deviate from the target model should be substantiated by the TSO and requires prior approval from the National Regulator after consultation of network users.

18. Cumulative balancing systems are not preferred by the members of EuroPEX because this policy option is characterized by the absence of a (daily) settlement of imbalances. In our view a daily settlement is desirable as it leads to the development of a robust price index for short term flexible gas (e.g. system average price and system marginal price on the On the Day Commodity market in the UK). The existence of a price index contributes to price discovery and trust in the wholesale market, which in turn contributes to a critical success factor of market based daily balancing: liquidity.

TSO buying and selling of flexible gas & procurement of balancing services

19. EuroPEX supports the recommendation of ERGEG that TSO trading on the wholesale market to balance the system is the option that is the most market based. Therefore we support the target model which obliges TSOs to procure the gas they need for balancing through buying and selling gas in the wholesale gas market on an equal footing with network users.
20. Were the wholesale market is insufficiently liquid the framework guideline proposes to use balancing platforms for the procurement of the TSO's gas balancing needs. In addition to our abovementioned concerns that the vague notion of liquidity triggers the establishment of such a platform, the wholesale market runs the risk of never becoming liquid enough because the TSO's balancing platform does. This problem of splitting liquidity between two markets has been observed in the electricity markets before (so called the 'liquidity trap'). In the impact assessment ERGEG has pointed out this risk and therefore we propose to include in the framework guideline the obligation on TSOs to set out a plan to integrate the balancing platform and the wholesale gas market as the latter develops to a sufficient degree of competition and liquidity.
21. Moreover, EuroPEX is doubtful that setting up a completely new balancing platform by the TSO (with no liquidity at all) is an appropriate response to the lack of liquidity of the wholesale market. Therefore the TSO should first try to buy or sell flexible gas on the existing wholesale market. By doing so the TSO sends a strong signal to all market parties that the system is outside of its safe operational limits and will attract liquidity. If buying or selling of flexible gas by the TSO on the wholesale market does not result in a timely and sufficient recovery of the system balance, then the TSO should be allowed to fall back on the balancing platform.

22. EuroPEX notes the importance of taking additional measures improve the liquidity of the wholesale market (e.g. 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 interim steps.
23. EuroPEX is strongly opposed against the possibility provided in article 8.6 of the draft framework guideline for balancing platforms to be used when there is a liquid wholesale market. The coexistence of a balancing platform and a liquid wholesale market would results into a split of liquidity that would have a negative effect on the reliability of prices. According to us a balancing platform is an interim step which could be taken in case the wholesale market is insufficiently liquid. Therefore the balancing platform should cease to exist when the wholesale market is sufficiently for the target model to be implemented.
24. EuroPEX notes that since the creation and operation of balancing platforms by TSOs is an interim step towards the integration of the procurement of balancing resource by TSOs in the wholesale market, we propose to include in the framework guideline the possibility for TSO to transfer (part of) these tasks to a (external and independent) market operator, such as Energy Exchange. The cooperation of TSOs and market operators, such as Energy Exchanges, already in the creation and operation of balancing platform, would facilitate the future integration of procurement of balancing resource in the wholesale market. Moreover, 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' members are keen on playing a vital role in the development, implementation and operation of balancing markets and platforms.
25. Article 8.9 of the framework states that “where there are *not sufficient parties* that can provide balancing gas through wholesale gas markets or balancing platforms competitive tendering processes may be used to procure long term flexible gas products”. As this option amounts to a significant deflection from the principle of market based (i.e. cost reflective) procurement of balancing gas, we would like to ask ERGEG to clarify what is precisely meant by *not sufficient parties*. As stated above we propose to base a decision to use a competitive tendering processes should be based on an objective competitive analyses of the market for short term flexible gas.

Imbalance charges for system users

26. The proposed target model for the calculation is fully support by EuroPEX. 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 should serve as the basis for the cash out price against which imbalances are settled between the TSO and network users.
27. Where dual pricing mechanism is considered we propose to apply an uplift of the price. This will incentivise network users who 'help' the system to trade on the wholesale market instead of waiting for the TSO to enter the market. This in turn fosters liquidity and further reduces the need for TSOs to enter the market for the buying and selling of balancing gas.

TSO cross border cooperation

28. As our members operate gas (balancing) markets across Europe, they agree with ERGEG on the importance of gas flows across borders for the further integration of European gas markets. The fact that sources of flexibility may come from across borders and the fact that characteristics of national balancing regimes have cross-border relevance, the framework guideline should address the issue of TSO cross-border cooperation. EuroPEX supports the target model as set forth in article 9 of the framework guideline.