Gas Balancing
An ERGEG Discussion Paper for Public Consultation
(18 July 2005)

Response by BP Gas, Power & Renewables

Key questions for stakeholders

Question (1):
Are there other features that should be reflected in a gas balancing regime to help ensure efficiency and to maintain safety and security of the system?

In addition to the tools mentioned, TSOs could be suitably incentivised to develop additional forms of balancing flexibility (or to permit others to do so) where there is a clear shortage. For example, if a TSO insists on an hourly balancing regime with high imbalance charges, and either restricts access to linepack or offers it only at a very high price, there may be a market failure if the TSO does not develop additional linepack and if it is infeasible for other parties to develop similar, competitive services.

We would also comment that certain protections may be needed when cashout is based on prices set in an illiquid market, which may have extreme levels of volatility. This could be achieved through large historic suppliers participating in a balancing market, for example with a fixed bid/offer spread, or by reference to a liquid hub as a floating cap.

Question (2):
Should the incentives to balance become stronger the further away a shipper is from being in balance or are there are other ways of ensuring that shippers have appropriate incentives to minimise their imbalance positions? Should shippers be allowed to trade their imbalance positions on an ex-post basis as a way of improving overall efficiency?

In general, this principle appears to have merit. However, we are concerned that it will be used as an excuse to set egregious cashout prices outside a reasonable tolerance zone. When regulated third party access was implemented in the UK, the cashout price inside the tolerance zone was based on average prices, where a shipper with a small imbalance would be cashed out at average market prices on the day, and a shipper with a larger imbalance would face the system marginal price. If this principle were used to defend a marginal price cashout within the tolerance band, and a cashout at a multiple of the marginal price outside the band, this would not be acceptable.

We support *ex post* imbalance trading as a transitional imbalance management tool while markets are immature.

Question (3):
Does hourly balancing create any barriers to the development of competition?

There are several additional reasons why hourly balancing creates barriers to the development of competition:

- Traded markets are daily, partly because upstream production contracts are daily-based. The imposition of hourly balancing may encourage buyers to use renomination rights to obtain a higher degree of flexibility than was intended when the contracts were negotiated. As this could lead to operational difficulties increasing risk of failure, to accelerated wear and tear on equipment, and to reduced reservoir integrity, it is likely to lead to increased costs and increased disputes.
- The minimum duration of transportation capacity service is one day. It is unclear why TSO's insistence on hourly balancing does not extend to transportation services.
- In order to participate in hourly balancing, a shipper must acquire hourly flexibility, which is mainly offered only by the TSO or by its supply affiliate. We are not aware of competition for providing services in this area. An onerous balancing regime has been seen to drive up demand (and therefore price) of services offered by the TSO or large historical supplier.
- The practical difficulties of dealing with hourly balancing include the collection of demand and supply information, obtaining historical data that allows reasonable forecasting, requirements for end-users to forecast hourly usage, management of additional balancing / tolerance tools, increased frequency of communication with producers and storage operators, increased within-day trading for small volume trades (including capacity). The consequent increase in transaction costs and risks of error (leading to penalties at punitive prices) should not be underestimated as a deterrent to companies wishing to compete in this area.

We would also comment that the UK discussion about implementing hourly balancing was done in the light of a daily-balanced regime with a liquid traded market. Even if UK had concluded that a switch to hourly balancing was good for the market, this does not mean that it would be appropriate for other markets to move directly to hourly balancing prior to the establishment of competition.

In the light of the above arguments, we would ask that ERGEG gives a much stronger signal that daily balancing is preferred and should be the default regime, for example through a presumption of daily balancing, with the burden of proof on TSOs to justify shorter balancing periods.

Question (4):
What information is required to ensure that gas balancing regimes operate effectively and efficiently and how often should this be provided? What is the best way of ensuring that this information is provided to all parties on a non-discriminatory basis?

We would like to see demand forecasts for the day regularly updated before and within the day, continuous information on pressure and whether the system is packing or draughting (this information is published on-line for many North American systems), and historical supply and demand data.

System balancing actions should also be published with the extent of the action, volumes and prices of gas bought and sold, and the justifications for the action.

Question (5):
Should linepack (where technically feasible) be made available to shippers on a non-discriminatory basis to improve access to flexibility? Are there any other steps that could be taken to improve access to flexibility that would not impinge on the safety and security of the system?

Where a TSO has implemented a daily balancing regime, it is reasonable that they should retain access to linepack as a tool for maintaining system balance. If there is surplus linepack, this could be made available to shippers on a non-discriminatory basis. Where hourly balancing regimes are in place, then the proportion of linepack being made available to shippers must increase substantially.

Question (6):
Do differences between (neighbouring) gas balancing regimes distort or the incentives provided to market participants? If so, what degree of consistency would be appropriate to overcome these problems? Would there be any disadvantages from introducing more consistency in features of (neighbouring) gas balancing regimes? How could this consistency be facilitated – for example would legislation be required or could it be achieved through better co-operation between regulators and TSOs in different Member States?

Issues around cross-border trading relate mostly to capacity availability and renomination rights. It is more important to resolve these than to concentrate on consistent balancing regimes (other than daily balancing).

The formalisation and implementation of OBAs would be a positive use of linepack to smooth out “noise” in the physical system such that commercial arrangements are not unnecessarily affected.

Question (7):
Would cross-border (or international) balancing zones help facilitate the development of competition in gas across Europe? What technical, legal and practical issues would need to be overcome if cross-border balancing zones were introduced? What impact could cross-border balancing zones have on the development of hub based trading and regional markets (see for example the recent ERGEG document on regional markets in electricity)?

The establishment of a regional system balancer taking actions in a regional market to set regional cashout prices does not presently seem to justify the amount of effort it would take to make this happen. We consider that the time would be better spent facilitating access to transportation and allow the market to determine via arbitrage and price convergence, where markets will become regional.

Question (8):

Would it be appropriate to increase the level of consistency between balancing rules for transit and transportation systems?

Where the pipeline systems are either combined or highly interconnected, it is essential that balancing rules are consistent to avoid the holders of capacity in one system having an inappropriate advantage over the participants in the other regime. Where transit and transportation are physically separate, then it may be possible to define separate services.

Question (9):
Would the introduction of Operational Balancing Agreements (OBAs) between transit and transportation systems improve transparency on how the balancing regimes interact? If so, what should be included in the OBAs?

Where transport and transit volumes are (or could be) travelling down the same pipe, then this should be carried out under identical arrangements and no OBA would be necessary.

Suggested changes to the existing CEER gas balancing principles

Principle 2
The suggestion that "Balancing rules should be designed to minimise the residual physical balancing role of the TSO subject to…" raises concerns that TSOs will use this to justify high imbalance charges. The effect of this would be to force shippers to hold high levels of flexibility and to spend significant effort in monitoring imbalances in order to minimise the residual balancing role of the TSO. However, this is inefficient, raising barriers to entry and causing shippers to hold much more storage in aggregate than is necessary to balance the system, raising costs for consumers.

We suggest instead that the rules "should be designed to optimise the efficiency of the system", and not to minimise residual balancing *at all costs*.

Principle 3 :
As stated earlier, we would prefer a presumption of daily balancing, with the obligation on TSOs to justify shorter balancing periods.

Principle 5
This principle recommends that "…they [tolerances] should be minimised as far as possible…". We recognise that the availability of over-generous tolerances could be abused in a mature market with daily (or longer) balancing periods. This is highly unlikely in immature markets in continental Europe, particularly in those with hourly balancing regimes, where tolerances are essential in allowing shippers with small portfolios to gain a foothold in the market. We propose that the principle be amended to recognise this, and should read "*Once a competitive market is established*, they should be minimised…"

DBW
29 Sept 2005