bne-Comment on:

ERGEG's Draft Pilot Framework Guideline concerning Gas Balancing Rules on European Gas Transmission Networks

Before we comment on ERGEG's draft framework guideline (draft FG) concerning gas balancing we would like to express our appreciation of the consultation *process*: The Third Package's provision to have *all* market participants set the frame for the TSOs' development of network codes is both a comprehensive and efficient approach. As an association advocating the interests of new entrants to the energy markets we also very much appreciate ERGEG's commitment to a market-based approach in gas balancing that lies at the heart of the consultation document.

While the balancing regime chosen is an important factor for the implementation and promotion of non-discriminatory and efficient competitive conditions, there are limitations to this highly welcome effect, one of them being a lack of liquidity in many balancing zones. Therefore, from the point of view of setting up a good balancing regime the need to merge balancing zones both nationally and EU-wide is apparent.

A final general remark on our position: For an association like ours, advocating the interests of new entrants, it could seem promising to argue in favour of any exceptional feature that could help new entrants. However, we don't hold that to be a wise strategy. Our aim is to arrive at a simple and EU-wide harmonised balancing system intelligently setting incentives to behave responsibly for all market participants. From our point of view simplicity is a value in itself, lowering barriers of entry. It also makes the system less prone to be weakened by a great number of features suggested to serve rent-seeking motives (above all, „tolerances" for specific groups generally pose a threat to an efficient system).

This comment is structured along the lines of the *Instructions for responding to the public consultation* and refers to the questions laid down in that document.

Telefon +49 30 - 400 548-0 | Fax +49 30 - 400 548-10 | www.bne-online.de
mail@bne-online.de | Berliner Sparkasse | Kto.: 636 281 12 | BLZ 100 500 00
Steuer-Nr.: 27/620/55384 | Vereinsregister-Nr.: 23212Nz | AG Charlottenburg

PROBLEM IDENTIFICATION, SCOPE, DEFINITIONS, PURPOSE, POLICY OBJECTIVES AND COMPLIANCE

Question 1: Do you agree that the problems identified in the problem identification chapter are the main ones? Are there additional problems that should be addressed within the gas balancing pilot framework guideline?

While we appreciate the comprehensive approach of the draft FG, we criticize that it does not mention distribution system operators (DSOs). Whereas it is obvious that with respect to gas balancing the market roles involved most are shippers and TSOs, DSOs play – at least in Germany – a role that must not be neglected when designing a balancing regime. This is specifically significant when it comes to market barriers for new entrants. A gas balancing regime can set incentives for the market roles involved. The DSO is such a market role. Where a role is not fulfilled satisfactory this needs to be addressed, ideally by means of incentivising it.

In Germany, around 700 DSOs exist, 96% of which are not effectively unbundled due to having less than 100.000 connected customers – following the De-Minimis-provision in § 7 para. 2, sentence 2 of the German *Energiewirtschaftsgesetz*, EnWG). Many of these DSOs do not properly fulfil their market role as neutral system operator, be it because of sheer lack of size and resources, be it because of the typically distorted interests of vertically integrated energy suppliers. This surfaces in different areas, with respect to gas balancing the supply of forecasts based on standard off-take profiles is most salient. Incorrect forecasts and intransparent calculation-methods increase the risks associated with the shippers' procurement (disproportionate for small ones), introduce information asymmetries in the market between new entrants and vertically integrated incumbents and increase the demand for balancing gas to be procured by the TSOs. This last problem grew to such a dimension in Germany that the National Regulatory Authority (NRA) had to introduce special measures to discipline the DSOs.

Whereas we assume that this problem is not present in all member states, we believe that it should be addressed by means of an optional clause in the FG.

Suggestion: The possibility to regulate DSOs; new article after article 4.3

We suggest to rename article 4, in order to include the role of DSOs to „*4. TSO and DSO information provision obligations*". Additionally we suggest to introduce the follow-

ing article after article 4.3.: (as 4.4, here 4.3.1 to avoid confusion with the draft's 4.4).

4.3.1 Balancing information to be supplied by the DSOs need to be made available by DSOs in a clear, timely manner and on the same timescale to all network users. Forecasts by DSOs need to be calculated according to best practice. If DSOs permanently fail to comply with the duties named in sentence 1 and 2 of this article the regulatory authority on national level shall introduce financial incentives (e.g. the introduction of balancing accounts for DSOs where an imbalance charge applies in case the DSOs forecasts deviates from measured off-takes) or other means to guarantee fair and efficient information provision.

Question 2: Do you agree with the scope (section 1) and objectives (section 3) of this pilot framework guideline? Are there policy issues that should, but are not currently addressed by the draft document?

• The scope of the draft FG:

We agree with the scope.

• The policy objectives of harmonisation, standardisation and synchronisation:

We strongly support the objective to design the EU member states' balancing regimes in a way that will make the EU energy markets move towards greater integration. Clearly, this can only mean harmonisation, standardisation and synchronisation of national regimes – necessary conditions for increased cross-border-trade, lower barriers of entry for companies wanting to operate EU-wide and future cross-border-balancing zones.

• The policy objective of moving towards market-based balancing regimes:

Since gas balancing regimes set incentives for market participants it is an important instrument to promote competition in energy markets. At the same time it needs to fit the realities to be efficient. These realities diverge remarkably within the EU member states, which means a big challenge for a European FG. However, we believe ERGEG's general approach to define both a target model and interim steps is a very promising way to meet this challenge.

• A policy issue not addressed: Moving towards the target model

However, the Commission's Energy Sector Inquiry has shown that competition has been slow to develop and that the market power of incumbents has remained dominant. We believe it will take rather vigorous and determined action on behalf of ERGEG and the Commission to overcome protective forces. On the one hand, this implies that the definition of both target model and interim steps should be clear-cut and not allow for too many alternatives. On the

other hand, it seems imperative to devote careful attention to provisions aimed at implementation and compliance. The draft FG provides that

- TSOs are allowed, upon NRA approval, to implement interim steps, where this may be appropriate (3.6);
- TSOs shall comply with the target model or the interim steps (10.1);
- ENTSO-G shall regularly review the progress towards implementing the target model (3.8).

In our opinion these provisions are not sufficient in order to activate dynamics towards harmonised market-based gas balancing in the EU. We are especially worried that the interim steps might serve as an excuse not to implement the target model. In that case the FG could even be counterproductive. We therefore emphatically suggest to elaborate on both the compliance rules and the definitions of interim steps.

Suggestion: Conditioned definition of interim steps

Every definition of an interim step needs to clearly specify the condition that makes its implementation (and therewith a deviation from the target model) necessary.

Only this way objective criteria for deviations from the target model can be introduced. This is important both with respect to the initial identification of an appropriate regime in each member state and with respect to managing progress towards the target model. This motivates the following suggestions.

Suggestion: Initial identification of an appropriate regime; amendment of article 3.6

3.6 Given the different stages of development of competition and liquidity in the gas markets across Europe, this pilot framework guideline defines interim steps towards achieving a common target model. The network code shall define balancing rules that are consistent with the target model but that allow for TSOs, upon NRA approval, to implement interim steps, where this ~~may be appropriate~~ is necessary and the requirements for the introduction of interim steps are fulfilled.

Suggestion: National implementation of the European network code; amendment of 10.1

We believe it is important that the NRAs are involved in implementing the European network code in the member states. In many member states significant changes will be necessary. In order to both establish legal certainty and to prevent strongly di-

verging interpretations each NRA should publish a binding statement on the national implementation of the European network code.

10.1. As soon as possible after the adoption of the network code the NRAs shall publish a statement specifying the necessary changes, including changes to existing contracts and the national network code. Once the European network code is adopted TSOs shall comply with the target model or the interim steps defined in the framework guidelines within 12 months. This includes the adaptation of existing contracts and, where relevant, national network codes. TSOs shall comply with the target model unless the NRA confirms that market conditions do not allow this.

Suggestion: Progress reports; new article 10.2

10.2 Where interim steps are implemented, NRAs report within twelve months on prevailing conditions and future progress towards the target model. Each NRA shall consult the TSOs and other affected market participants in the process of drafting the report. It shall lay down the reasons for not implementing the target model, shall identify market events, NRA- and TSO-action that might help to overcome limiting conditions and shall contain a roadmap for the implementation of these instruments leading up to the target model. After the initial progress report the NRA publishes annual progress reports until the target model is implemented.

Suggestion: Obligation to move towards the target model; new article 10.3

When limitations making the implementation of any given interim step necessary are overcome, there should be an obligation to move towards the target model. In Germany for example the fusion of balancing zones is expected to lead to more liquid markets which would allow the procurement of balancing gas by the TSOs to be more market-based.

10.3 When a limiting condition preventing the target model to be implemented is overcome the interim steps justified by this condition need to be replaced by provisions of (or closer to) the target model.

Suggestion: Monitoring of progress by ACER; new article 10.4

10.4 The agency regularly monitors progress towards the target model (article 9(1) of the Gas Regulation 715/2009). Part of its monitoring are reviews of the progress reports according to article 10.2 and 3.8.

Question 3: In your view, should the European network code for gas balancing lead to an amendment of national balancing rules? If so, how detailed should the European target model be?

Clearly, national balancing rules need to be amended in order to arrive at the abovementioned policy goals. There will be no harmonisation and no impulse for market-based balancing if national rules are not being changed.

Obviously, the target model needs to go into some detail in order to be able to facilitate EU-wide operations of energy companies and to encourage cross-border trade and cross-border balancing. It needs to be detailed enough to harmonise the operationally relevant processes that can be harmonised EU-wide. Measured against this criterion the draft FG lacks (more detailed) provisions on the following:

- Nomination processes
- Data exchange processes
- IT standards
- Provisions on how to deal with caloric values in balancing
- Provisions on the calculation and harmonisation of off-take profiles

Now, we don't believe the FG and in consequence the first European network code are the right place to harmonise these areas. It seems to make sense to start with harmonising only the principles of gas balancing in a first step. We do suggest however to introduce a declaration of intent, the assignment of responsibilities to market roles and a roadmap for the next steps necessary to capture the full potential of harmonising gas balancing in the EU.

Suggestion: Future harmonisation intent and roadmap, new article 10.5

10.5 Eighteen months after the adoption of the framework guideline and based on evaluations of the network code the agency shall prepare a regulation, dealing with the harmonisation of areas not covered by the network code and judged to be important for further progress towards harmonised and market-based gas-balancing, e.g. nomination processes, data exchange processes, IT standards, caloric values and off-take profiles.

Question 4: Do you agree with the approach of defining a target model for the network code and allowing interim steps subject to NRA approval?

We agree with the general approach subject to the abovementioned design: 1) An unambiguous definition of the target model, 2) objective criteria for the acceptability of implementing interim steps instead of the target model, 3) the management of progress from interim steps towards the target model and 4) an important role of ACER in monitoring progress.

Additionally, many interim steps of the draft FG do not seem to be true interim steps: second-best-solutions responding to limitations caused by the general market structure that can be overcome in future. They rather seem to be containers for different types of possible and actual regimes. While this is unproblematic or even good for a draft, the final guideline needs to define a clear-cut target-model and well-justified interim steps leading towards the target model. Only this way harmonisation is feasible.

We would like to highlight the great importance of these issues: If target-models and interim-steps are not well-defined and if progress towards the target-model is not thoroughly managed, the whole enterprise of introducing EU-wide balancing-rules, a key element in promoting a functioning internal gas market, will be in vain.

Question 5: What timescale is needed to implement the provisions in the target model outlined in Part II after the network code is adopted? Is 12 months (as in section 10) appropriate or should it be shorter or longer?

12 months is sufficient for the adoption of the network codes.

Question 6: Should the pilot framework guideline be more specific regarding the purpose and policy objectives for network codes (section 3), in particular areas including nomination procedures?

See above our answer to question 3. An additional remark with respect to nomination procedures: Art. 8(6) of gas regulation 715/2009 (and article 3.3 of the draft FG) requires the network code to contain some provisions on nomination procedures, while the draft FG contains no rules on this area.

Now, since nomination procedures are of vital interest to all market participants and since the network code will contain corresponding provisions, the FG needs to also set a frame for ENTSO-G's network code in this area.

Question 7: With reference to section 3 (proposed policy objectives), do you have comments on how Article 21 of the Gas Regulation 715/2009 should be reflected in the gas balancing network code?

We have no comments on this.

Remarks on the definitions (chapter 2)

• The guideline primarily addresses the market roles of the TSO (German „Marktgebietsverantwortlicher") and the shippers. The **role of the DSO** is not being mentioned:

All references to the Transmission System Operator (TSO) refer to the entity responsible for keeping the system in balance. Where this is a party different from the TSO, references to TSOs in this document relate to that party (p. 14)

At one point of the document a responsibility of German DSOs is attributed to the TSO: information provision with respect to standard load profiles (chapter 8.3).

While it would technically be possible to subsume both „Marktgebietsverantwortlicher" (the German TSO-market role within the balancing system) and the DSO under the term „TSO" of the draft FG, we suggest to add a separate definition of the term „DSO" there. Only that way the specific responsibilities of the DSOs for good forecasts through standard load profiles and other local measurement and information provision processes can be addressed.

Suggestion: Introduction of a definition of „Distribution system operator" (DSO)

The following definition is taken from Directive 2009/73/EC concerning common rules for the internal market in natural gas.

"distribution system operator" means a natural or legal person who carries out the function of distribution and is responsible for operating, ensuring the maintenance of, and, if necessary, developing the distribution system in a given area and, where applicable, its interconnections with other systems, and for ensuring the long-term ability of the system to meet reasonable demands for the distribution of gas.

• **The term „market area"** is not being defined or used in the remainder of the document. For that reason we suggest to drop the cancelled sentence, since in Germany at least, the idea of a market area („Marktgebiet") *is* to have a single balancing zone.

Suggestion: amendment of the definition of „balancing zone":

'Balancing zone' is defined by an entry-exit system for which the specific balancing regime is applicable. ~~One market area can comprise several balancing zones.~~

• **The term "Cross-border balancing"** is supposed to refer to the exchange or trade of flexible gas between neighbouring balancing zones *in different member states*. This should be included in the definition.

'Cross-border balancing' means both the exchange or trade of flexible gas between neighbouring balancing zones <u>located in neighbouring member states</u> in order to facilitate market integration and the arrangements between network users to trade out their imbalances across two adjacent balancing zones.

The term "Cross-border balancing" is supposed to refer to the exchange or trade of flexible gas between neighbouring balancing zones *in different member states*. This should be included in the definition.

• The definition **of the central term „imbalance"** is rather vague:

'Imbalance' is when individual network users' injections to the system differ from their off-takes or where aggregate inputs to the system differ from aggregate off-takes from the system in a balancing period. This may result in either individual network users and/or the TSO buying or selling gas (or the TSO buying balancing services) in order to offset the imbalance. Inputs and off-takes to and from the transmission system can take the form of either physical gas at a specific point or gas exchanged at a virtual point in the market.

The vagueness („or…may…and/or…can") is attributable to the following: When talking about ‚imbalance' we are dealing with two very different things. 1) An ‚imbalance' can refer to the difference between injections and off-takes of gas attributed to a shipper at the end of the balancing period. This kind of imbalance is a calculatory magnitude that can diverge from real differences, e.g. in case tolerances are applied. This type of imbalance is the basis for computing imbalance charges. 2) An ‚imbalance' can also refer to the physical state of a system at any given point in time. This concept of imbalance is closely tied to the TSO's activities aimed at system stability: use of linepack and storage, buying and selling of physical gas.

Although these two concepts refer to related phenomena, this relation is under most regimes not as direct as to justify not using different terms. In a daily balancing regime for example, it can be the case that all shippers are in balance at the end of the gas day but the system has been out of balance, forcing the TSO to intervene. It is also possible that none of the shippers are in balance at the end of the gas day but no regulating TSO-action was required. This makes it hard to attribute imbalances of the system to imbalances of the shippers. But since this relation is a highly important matter it must not be confused terminologically.

Suggestion: Two terms and definitions of „imbalance" instead of one

We suggest to introduce two different terms, defined along the lines of the discussion above. Terminological options include: „balancing energy" vs. „control energy" (translations of the German terms) or „shipper imbalance" vs. „system imbalance".

THE ROLE OF NETWORK USERS AND TSOS

Question 8: Is it necessary to have a harmonised approach to the network user and TSO roles regarding gas balancing?

Harmonisation of network user and TSO roles is of great importance for the development of a functioning internal EU gas market. It creates EU-wide similar environments for companies operating in more than one member state and facilitates cross-border trade and encourages cross-border balancing.

Question 9: What are your views on the proposals for the target model to be reducing the need for TSOs to undertake balancing activities?

We agree with this proposal since a more prominent role of the TSOs which are in many cases still the incumbents or controlled by them one way or the other would amount to retaining or even worsening intransparencies and barriers to market entry.

That said, it is important to understand that it would be counterproductive to take this proposal to extremes. If the responsibility for keeping the system in balance is shifted completely to the shippers, high demands with respect to short-term gas-procurement, data analysis and communication would be caused. It would also mean high exposure to risks associated with imbalance charges. This again, would imply high barriers of entry and disadvantages for small companies.

We therefore believe, a compromise needs to be found, well on the side of shipper responsibility. A key element in this is a daily balancing regime which both incentivises shippers to balance injection and off-takes and accepts a certain level of TSO-balancing action.

Question 10: Is it appropriate for the target model to impose within-day constraints on network users? If so, should such constraints be imposed on all network users or only on certain groups of network users? If within-day constraints should only be imposed on certain groups of network users, which ones are these? How could this be justified?

The question of appropriateness is an empirical question. While for some networks it may be necessary to introduce within-day constraints, this might not be the case for others. We suggest to assign within-day constraints an optional status. They should be implemented only in case a cost-benefit-analysis proves that the advantages of less TSO-balancing outweighs the disadvantage of higher demands placed on shippers. The option to implement within-day

constraints only for some types of injections and off-takes needs to be assigned an optional status and evaluated by means of cost-benefit analysis.

Question 11: Is balancing against a pre-determined off-take profile a useful interim step?

Balancing against a pre-determined off-take profile is not only useful as an interim step. As long as there is no daily or even real-time information on household gas-consumption there is no alternative to using forecasted values for the shippers' balances. As a matter of cost-benefit-considerations it is highly doubtful that in foreseeable future all household customers are equipped with remotely readable meters. In addition, well-kept off-take profiles may be completely sufficient for the needs of balancing especially in gas network systems with a high degree of flexibility (e.g. linepack). For these reasons it makes sense to include off-take profiles in the target model.

However, the following needs to be guaranteed: 1) The profiles and other tools and information used for these forecasts need to be harmonised as much as possible; 2) The forecasts and all information needed for their calculation need to be supplied by the DSO (or whoever is responsible) as early as possible, free of charge and in a standardised electronic form; 3) Incentives for the DSOs need to be introduced to guarantee best practice with respect to the accuracy and the provision of their forecasts.

Inaccurate, intransparent or delayed forecasts will increase demand and costs for TSO-balancing as well as risks with respect to gas-procurement, especially for new entrants (see above, our suggestion under question 1).

Question 12: Should TSOs have the option to sell flexibility provided by the gas transmission pipelines system (linepack) subject to the NRAs' approval? If so, should this be mandatory?

The TSO must use all internal resources when trying to keep the system in balance. That is, all linepack needs to be used before external balancing gas is procured.

That said, TSOs should (upon NRA-approval) have the option to sell any extra-linepack available when physical balancing needs are satisfied. This way the TSO would increase liquidity of the market and generate additional revenues without assuming the role of a trader (trying to sell linepack at a higher price than he is buying external control energy at). In order to guarantee this, transparency is highly important.

Suggestion: TSO's should sell linepack strictly at times where it is not needed to balance the system

5.4. The network code shall provide for TSOs to allocate linepack to network users if approved by the relevant NRA. Only linepack that is not needed to balance the system shall be sold. TSOs shall allocate the linepack to network users on a transparent and non-discriminatory basis. Where linepack is sold, it shall be offered at a cost reflective price. The price may also be determined through competitive mechanisms. The decision by the relevant NRA to allocate linepack will be based on objective criteria, including the physical characteristics of the networks and whether the provision is consistent with the target model for the balancing period.

Question 13: Should the target model enable TSOs to provide tolerances to market participants for free or should this be an interim step?

There should be no tolerances since they reduce the incentives to balance injection and off-takes. It would lead to especially vertically integrated suppliers strategically optimising against the tolerances which would lead to a rise in demand for external balancing gas by the TSO. The rise in complexity could also offset the advantages tolerances might have for new entrants.

We can think of a single exception: Small tolerances answering to variations beyond the control of any market participant and not distorting incentives could be granted. An example would be to introduce a 2% tolerance for all groups covering measuring inaccuracy and variations of caloric values.

Suggestion: Restricting the option to grant tolerances

5.9. TSOs may provide network users with tolerance levels that shall reflect measuring inaccuracy and variations of caloric values ~~genuine system flexibility and user needs and address in particular the needs of small users and new entrants~~. These tolerances ~~may~~ shall be free. The level of tolerances allocated to each network user shall be identical ~~designed so as to not create discrimination, in particular towards network users with smaller gas portfolios~~.

Additional comment concerning the interim steps

Ex-post balancing, like tolerances, work against the incentives for the shippers to balance their portfolio and should therefore not be granted.

Suggestion: Deleting the option to grant ex-post balancing

~~*5.8. Groups of network users may be entitled to aggregate their inputs and off takes within a balancing zone, after the end of the relevant balancing period..*~~

TSO OBLIGATIONS ON INFORMATION PROVISION

Question 14: Are there any additional information requirements that you believe should be included? In particular, should the pilot framework guideline oblige TSOs to provide information beyond the requirements set out in the revised Article 21 and Chapter 3 of Annex 1 to Regulation (EC) No 715/2009 (as recently approved through comitology)? If so, please provide details?

All information shippers need to carry out their day-to-day business need to be provided electronically in a standardised, machine-readable manner. It is not sufficient to publish information on TSO-websites or to transmit them in non-standardised formats. Searching and converting information supplied this way increases transaction costs especially for new entrants.

The information necessary, the formats and the data-exchange-processes will depend on the concrete balancing system chosen and cannot be addressed at this point (see our answer to question 3). This gives rise to the following:

> **Suggestion: Tightening article 4.4**
>
> *4.4. TSOs shall provide, free of charge, to each network user ~~the available~~ information regarding its inputs on to the system and off takes from the system at appropriate intervals during the balancing period in order for network users to be able to balance their portfolios.*

Question 15: What are the benefits and disadvantages of TSOs providing network users with system information?

As long as information is provided in an indiscriminate manner, it increases transparency. We don't believe that any specific information on the system needs to be withheld in order to e.g. prevent manipulation. In addition, a design necessitating secrecy would be a bad design, since that would introduce or increase the danger of inside information leaks where the TSO is not completely unbundled from all network users. Since networks are regulated natural monopolies there are no industrial secrets that need to be protected.

Question 16: What are the costs of TSOs providing network users with system information? How do these compare against the benefits and/ or disadvantages?

The TSO's costs associated with processing and sending data already available to the shippers are low. Overall disadvantages are only to be expected where the TSOs' costs of *collecting* information are being socialised one way or the other and higher than the benefits. One

example would be a mass roll-out of smart meters necessary for providing real-time information on all household-customers' off-takes.

BALANCING PERIODS

Question 17: What are your views on our assessment of the policy options?

We agree with the assessment.

Question 18: Are there relevant additional policy options on balancing periods which have not been considered in this section? Should these be considered going forward?

In our opinion, there are no additional options deserving consideration.

Question 19: Is it necessary to harmonise balancing periods? If so, what are the benefits of a regional or pan-European harmonised balancing period? If not, why is it not necessary? Please explain your answer.

It is necessary to harmonise balancing periods in order to facilitate cross-border activities throughout the European Union.

Question 20: If you agree with a harmonised balancing period, what do you consider is the appropriate length of the balancing period?

The appropriate length of the balancing period is one day. This is the best trade-off between competition-friendly simplicity and low costs of balancing the system. In case of significant problems with system stability or costs for the TSO's procurement of gas, additional or alternative within-day incentives for some injections and off-takes can be introduced (especially large injections and industrial consumers).

Question 21: Do you agree with the target model? (Please explain your answer).

We agree for the abovementioned reasons.

Question 22: What would be the costs of implementing the target model in (and beyond) your Member State or balancing zones(s) (as the case may be)?

The target model is already implemented in Germany, there are no additional costs.

TSO BUYING AND SELLING OF FLEXIBLE GAS AND BALANCING SERVICES

Question 23: Do you agree with our assessment of the policy options?

We agree, but would like to add a supporting reason for preferring procurement of balancing gas through the wholesale-market or – where this is not possible – through balancing platforms. Some TSOs are – at least in Germany – not independent of the former monopolist's gas supplier. For that reason, a regime that does not provide a maximum of market transparency cannot sufficiently curb the TSO favouring his associated supplier. Market transparency is implemented best by integrating balancing gas procurement into the wholesale market.

Question 24: Do you agree with the target model? (Please give reasons). If so, what do you consider are the benefits and disadvantages of the target model?

We agree with the target model. Short-term procurement through the wholesale-market is the best way to guarantee non-discrimination and transparency. In addition it puts a market-price on gas that can be used as a basis for imbalance charges effectively incentivising shippers to balance their portfolios.

Question 25: What are the costs of implementing the target model in your Member State?

In Germany gas-balancing procurement practices vary between market areas. Costs of implementing the target model are low, since national law provides for the number of market areas to be reduced. After the pending fusions market-based procurement of balancing gas established in the liquid market areas will simply extend to the territories of former low-liquidity market areas.

Question 26: What interim steps, if any, may be needed in your Member State or balancing zone(s)?

Fusions of market-areas will be necessary in order to increase liquidity. In order to deal with the low liquidity in low-caloric gas markets the fusion of market-areas with different gas-qualities is of salient importance and at the same time, as studies have shown implementable. Cross-border-fusions are also an option.

Question 27: Is it appropriate for balancing platforms to be part of the target model subject to NRA approval, even where markets are sufficiently liquid to enable TSO procurement on wholesale markets?

Ideally procurement of balancing gas should be integrated into the wholesale market. Demand for local balancing gas is an issue that needs to be addressed, but does not make separate balancing platforms indispensable. We therefore advocate to not allow balancing platforms where there is enough liquidity.

Question 28: Is it appropriate for TSOs to procure balancing services on the wholesale market and/or or is appropriate for these to be procured on the balancing platform? Should TSOs be permitted to reserve long-term contracts for flexible gas and/ or associated capacity for this purpose?

The more market based the procurement of balancing gas is conducted the better. The network code needs to oblige the TSOs to procure balancing gas through the wholesale market where there is enough liquidity to ensure system stability. The feasibility of this model has been proven by the British experience. Only where there are barriers to implementation of this best practice model putting system stability at risk, alternative regimes need to be considered in this order: balancing platforms, regular tenders. Long-term bilateral contracts between TSOs and suppliers do not fit the idea of market-based balancing and competitive gas markets.

Question 29: In your view is it possible in your market to reduce TSOs' reliance on long-term products? If so, how may this be best achieved?

The key to market-based procurement of balancing gas is liquidity. Liquidity can be increased by a number of measures, the most important one being the fusion of market areas with low liquidity.

IMBALANCE CHARGES

Question 30: Do you agree with our assessment of the policy options?

We agree with most aspects of the assessment. There are some points we would like to comment on:

As the *Initial Impact Assessment* argues, charges should target those that have contributed to a system imbalance. Now, as argued above (our remark on the definition of „imbalance", p. 9), there is – at least in a strictly daily regime – only a very indirect relation of contribution

between the shippers' and the system's imbalances. That is, at least within-day contributions of a shipper to a system imbalance is not being charged if it does not result in an end-of-day imbalance of the shipper. This kind of imbalances is accepted within this regime just as the costs the TSOs balancing-actions cause.

It follows that a balancing regime can be satisfactory *without* a (well-defined) attribution of system imbalances to shipper imbalances. Put differently: It is an open question whether or not a balancing regime should be implemented that tracks the systems' status and the shippers' injections and off-takes in a way that allows charges to target the shippers responsible for system imbalances. It may be simpler and sufficient with respect to system stability to set incentives for the shippers to balance their portfolios on a daily basis and to have the TSO take care of system imbalances. What is more: Even if system stability cannot be guaranteed or if the TSO-induced costs for balancing are too high in a daily regime, an additional hourly system (for all or a group of injections and off-takes) can be implemented, that again only sets incentives for the shippers to balance their portfolio. This could solve problems of stability or costs and again, there need not be a close attribution of who caused imbalances.

We have elaborated on this point because the information processes required to implement rewards (punishments) for „helping" („harming") the system are technically demanding and much more complicated for the shippers to deal with. Also it introduces a certain complexity that, especially in markets with limited liquidity might be used to use market power, to optimize against the system or other market participants. All this may prove disadvantageous especially for new entrants. At the same time the benefits with respect to stability and costs for TSO-balancing may be limited. This entails our following suggestion:

Suggestion: Deleting strong references to charges reflection contributions of shippers to system imbalances

7.2. The network codes shall require TSOs to charge separately imbalance charges from other transmission charges. Imbalance charges shall be reflective of the costs incurred by the TSO in buying gas and balancing services (or the revenues received by the TSO in selling gas) to the extent this is possible. ~~Imbalance charges shall be levied on the network users that contributed to the imbalances. Only costs incurred by TSOs, undertaking balancing activities that are not directly attributable to a network user causing imbalances may be shared across all network users. Imbalance charges shall be targeted on the network users contributing to the imbalance and therefore shall not include other charges.~~

7.7. ~~Such imbalance charges when applied to individual network users may reflect whether the network user's imbalance contributes to the overall imbalance on the system or helps to reduce the overall system imbalance. The principle would be that the imbalance charges of network users that con-~~

~~*tribute to the system imbalance should reflect the balancing actions taken by the TSO in accordance with 7.6. above. The imbalance charge of network users whose imbalance helps to reduce the system imbalance would be based on the price in the wholesale market.*~~ *The imbalance charge may also include a small uplift in order to incentivise the network users to balance their portfolios. This uplift shall not deter market entry or impede the development of competitive markets.*

Question 31: Do you agree that methods for calculating imbalance charges should be harmonised? If so please explain what the benefits may be. If not, please explain why not.

We believe the methods for calculation imbalance charges should be harmonised to lower barriers of entry, to facilitate cross-border trade and to set up structures facilitating cross-border balancing-zones.

Question 32: What are your views of the target model?

We believe, a simple and effective regime can be described as follows:

- There are incentives for the shippers to balance their portfolios at the end of the balancing period (As discussed above: If system stability is threatened or the TSO has to undertake too much balancing action the balancing period can be shortened, maybe only for some injections and off-takes).
- These incentives consist in imbalance charges for any portfolio imbalance. The charges are designed to make it less attractive to pay them than to procure or sell gas in order to balance the portfolio.
- Imbalance charges shall be reflective of the costs incurred by TSOs in buying gas and balancing services. In the target model, where liquid wholesale markets are taken for granted, these costs converge with the costs the shippers are facing in the wholesale market. However, where procurement of balancing gas is not possible only through the wholesale market, there may be higher costs for the procurement of balancing gas. In this case especially new entrants need to be protected from extremely high imbalance charges, since their small portfolios are more likely to have larger relative imbalances.

Thus we agree with the target model, subject to the important modifications of eliminating rules based on „contribution" as discussed in the answer to question 30.

Question 32 (cont'd): In particular, please provide your views on:

- **Whether an imbalance charge should be applied when TSOs do not take balancing actions;**

  On the one hand, in order to keep the role of the TSO as small and the whole system as lean as possible, we believe no imbalance charges should be applied when there were no costs in a given balancing period.

  On the other hand there could be a destabilising effect of not charging while the system is in balance. Given the system has been in balance for some days shippers will rationally hold the belief that this will also be the case for the current day. Since they expect not to face imbalance charges their discipline to balance their portfolios will decrease, reducing their costs of short-term procurement. This will encourage free-riding and can eventually, when enough shippers (rationally) act that way, lead to the system moving out of balance, increasing demand and costs for balancing energy.

  We advocate to not apply imbalance charges when no TSO balancing action has taken place in a balancing period if it is unlikely that this will destabilise the system. If on the contrary this is likely, we advocate to apply imbalance charges in every balancing period. The likelihood of stability and instability are to be estimated by the NRAs and shall be the only criterion to decide on this issue.

- **What the imbalance charge should be based on, if it is applied when the TSO has not taken a balancing action, whether imbalance charges should be dual or single priced;**

  In that case the charges should be based on the wholesale price. If the shipper is short he should pay the wholesale price plus an uplift. If the shipper is long he should be paid the wholesale price minus a markdown. Both uplift and markdown should be small but large enough to generate an incentive to balance the portfolio instead of paying imbalance charges.

- **Whether imbalance charges should be based on the marginal price.**

  Yes, the imbalance charges should based on the marginal price paid by the TSO for balancing gas.

Question 33: What would be the costs and benefits of implementing your preferred options in your Member State?

The system described is more or less implemented in Germany. The additional costs will be comparatively low.

Question 34: What are your views on the interim steps in the document?

For the target model it seems reasonable for the TSO to charge the costs of system balancing to the shippers through the imbalance charges, i.e. proportionally to their portfolio imbalances. Other costs of the TSO may be „socialised", i.e. attributed independently of the shippers' portfolio balances as a certain rate on each unit of energy.

However, in an imperfect environment there may be reasons for deviating from this model. In Germany, for example, the DSOs' bad forecasts for off-take profiles are a major source of the demand for control energy. As suggested commenting on question 1, the best solution would be to make the DSOs financially responsible for bad forecasts.

A second-best-option could be differentiated socialisation of costs: Since the forecasted values are valid for balancing, bad forecasts do not cause imbalance charges and the costs caused are socialised. This means little pressure is generated to arrive at best practice. In addition, one group (customers with off-take profiles) is being subsidised by another group (customers with more accurate forecast- and measurement technology). It therefore seems reasonable to have the network charges reflect these differences in accuracy of matching injections and off-takes.

Suggestion: Introducing differentiated socialisation of costs; new article 7.11

In case of network users' failure to comply with their role causes costs for balancing actions that do not appear in the shippers' portfolios but can be attributed to a certain group, the TSO may, upon NRA approval, introduce differentiated socialisation rates reflecting the different groups' contributions to these costs.

CROSS-BORDER COOPERATION

Question 35: Are there any other relevant policy options on cross-border cooperation that should have been included in this section?

No.

Question 36: Do you agree with our assessment of the policy options in this section?

It is an open question if, in the long run, a single balancing zone will be the most efficient solution. But it is clear that the demarcation of national boundaries can not serve as objective criteria for an efficient design of European balancing zones – many cross-border-mergers will be highly economic. For that reason, as an alternative to a single European balancing zone, a relatively small number of regional balancing zones in Europe could emerge as the best design.

We therefore support the suggested approach to have the network code provide for the TSOs to merge with neighbouring balancing zones, subject to an evaluation through cost-benefit analyses.

In our opinion the other suggested options do not need to be dealt with in the network code, for several reasons: Partly they are already in place where they make sense (TSO-balancing); also, they are just as costly to implement as mergers, but have dubious positive and additional negative consequences; finally, their establishment could delay progress towards the only truly competitive arrangement, unified balancing zones that is.

Question 37: Are Operational Balancing Accounts (OBAs) useful to deal with steering differences? Should the network code make it mandatory on TSOs to put in place OBAs?

-/-

Berlin, 28 October 2010