

EURELECTRIC comments on CEER Call for Evidence “Vision Paper for a conceptual model for the European gas market”

A EURELECTRIC Response Paper



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■ Growth, added-value, efficiency

Environmental Leadership

■ Commitment, innovation, pro-activeness

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■ Transparency, ethics, accountability

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GENERAL REMARKS

EURELECTRIC, the trade association representing the electricity industry at pan-European level, recognises the importance of the development of a target model aimed at improving gas markets functioning and facilitating the integration of the currently fragmented national gas markets. Indeed, a comprehensive vision on what is required to steer and facilitate the implementation of the 3rd Package needs to be developed.

Starting from the principles of unbundling as described in the 3rd Package, the model should aim at providing a complete and joined up view of how core aspects of market operation described in the Framework Guidelines (FGs) and Network Codes (NCs) interrelate with each other, and how harmonising them will improve market functioning and promote market integration. The target model shall be aimed at standardised, harmonised and consistent capacity related arrangements.

For the reasons stated above, EURELECTRIC supports the development of a gas target model and recognises the benefits it could provide in paving the way to the internal market for natural gas. The target model should particularly aim at:

- Ensuring that consumers have access to secure, competitive and more flexible gas supplies;
- Boosting the development of liquid and transparent wholesale markets by e.g. enhancing cross-border trading and eliminating restrictions on trade (where present) and reinforcing interconnection capacity where necessary (particularly in some regions);
- Providing guidance and coordination to developments at regional level.

Major uncertainties surround the development of gas markets nowadays. Gas demand has been seriously affected by the recent economic downturn; despite some signs of recovery are currently being witnessed. Gas supply has dramatically changed driven by the boom of unconventional gas resources, particularly in the United States, as well as by the increase LNG capacity worldwide. Last but not least, increased penetration of renewable energy sources, particularly of non-dispatchable (or intermittent) sources such as wind and solar power, in the European electricity systems has led and is increasingly leading to reduced operating hours of gas-fired power stations, thus changing natural gas consumption patterns.

Where does the main challenge lie for the gas market in our view?

The future role of natural gas in the European energy mix is fairly unclear at the moment, with numbers varying considerably according to the scenario/modelling that one takes

into account¹. This is, first and foremost, due to the new principles set out in the EU energy policy post-2007, when the European Council agreed that the Union should aim at ensuring energy usage in a way that is competitive, greener and safer.

Further to the commitment that Europe has to cut its greenhouse-gases emission by 20% and increase the share of renewable energy to 20%, the EU has witnessed a tremendous growth of renewable sources in electricity generation – and in particular wind and solar power. In some EU countries, this massive increase has “compressed” natural gas baseload or even mid-merit plants contribution to electricity supply, pushing those plants on the right-hand side of the merit order curve and forcing operators of gas-fired stations to incur losses and to change their business plans where those had been centred on gas-fired generation². Besides the crowding-out effect just described, the increased penetration of non-dispatchable RES has led to more intermittent generation from gas-fired stations which had and will increasingly have to start-up and shut-down more frequently and with very short lead-times – which will in turn lead to greater volatility of demand and prices.

The trends just described have only recently occurred; but they will become even clearer in the next few years due to the boom that intermittent renewables are experiencing and will experience throughout Europe³. It is straightforward to say that EURELECTRIC members have a material interest in procuring gas for their power plants flexibly and competitively on a pan-European gas market.

What do we expect from the future?

Summarising what has been briefly presented above, EURELECTRIC believes that the only certainty we will have in the future is that uncertainty on how gas supply and demand will evolve in the short to long term will be the rule. Despite this high degree of uncertainty, some trends can be observed:

- Gas-fired power plants are required to run more flexibly, thus operating along different patterns and with different load factors
- Gas demand and prices become more volatile
- Greater need for system flexibility and storage
- Increased risk to suppliers from the decoupling of gas spot prices from those of existing long-term take or pay contracts⁴
- Heightened need for deep and liquid pan European gas market

¹ The European Commission, for instance, has compared several scenarios which give evidence to the uncertainty surrounding the EU gas demand, see DG Energy, *Impact Assessment accompanying the Energy Infrastructure Priorities for 2020 and beyond – a Blueprint for an integrated European energy network*, November 2010

² EURELECTRIC, *Integrating intermittent renewable source into the EU electricity system by 2020: challenges and solutions*, March 2010.

³ In 2009, the installed capacity of wind power alone grew more than the combined increase of all conventional generation sources. Roughly 10.7 GW of wind farms came on stream in 2009, compared to 10 GW of fossil-fuel fired stations. Data in EURELECTRIC, *Power Statistics 2010*, December 2010.

⁴ Notwithstanding this, long-term commodity contracts, linked to long term capacity contracts, may still have a role to play in framing pipeline investments and hedging security of supply risks.

EURELECTRIC believes that in developing a gas target model the European Commission, the regulators, the Transmission System Operators and all stakeholders participating in the Gas Regulatory Forum, and particularly all market players, need to take into account the situation described above and ensure that the highest degree of cooperation among them is attained. Natural gas will indeed play a key role in the future energy mix as it will contribute to integrate intermittent renewables into the markets.

EURELECTRIC VIEWS ON THE CONSULTATION'S QUESTIONS

Whilst the above sections tried to answer the first two questions of CEER consultation in a more general way, the points below focus on the remaining questions trying to assess the details of the target model.

- *3. What are in your view the key elements of a conceptual model for the European gas market to contribute to non-discrimination, effective competition, and the efficient functioning of the internal gas market? Please include views on the key aspects of market design such as, capacity allocation and congestion management procedures, network tariff arrangements, wholesale market pricing, balancing arrangements and, gas quality specifications? Please consider the interaction of these arrangements.*

In its previous responses to the public consultations on the Pilot Framework Guideline on Capacity Allocation and the Pilot Framework Guideline on Gas Balancing, EURELECTRIC has already expressed some views on the target models proposed there. The following section builds on those responses and also gives some preliminary views on other issues such as tariff arrangements and transparency.

Capacity allocation and congestion management:

- Capacity should be financially firm and TSOs should be allowed to oversell and buyback capacity
- Allocation of new and existing available interconnection capacity via market-based mechanisms, e.g. auction or open season, with harmonised products and timescales throughout the EU and by using a transparent and cost-reflective methodology
- Set aside a proportion of available capacity for short term release to facilitate arbitrage between market areas
- Combining entry and exit capacity at either side of an interconnection point
- Bundling capacity at one or more interconnection point into a single entry/exit product between market areas as a final step towards integrating those market areas into a single balancing zone
- Virtual reverse flow at all interconnection points
- TSOs to register secondary capacity trades at interconnection points
- TSOs to be incentivised to maximise capacity at interconnection points

Balancing:

- Common end of day balancing arrangements with limited and non-discriminatory within day flow constraints within each market area

- Non discriminatory access to storage and linepack
- Single cleared gas exchange for TSO balancing action, which market participants can also access bilaterally
- Single balancing market operator in integrated markets
- Standard renomination lead times that allow for a coordinated interaction between gas and electricity markets
- Common gas quality parameters within market areas with TSOs resolving any quality differences for flows within and between market areas

Tariff structures:

- Entry/exit capacity
- Consistent and transparent methodology for setting reserve prices and for triggering investment
- Methodology to apportion quality conversion costs and TSO revenues

Transparency:

- Consistent application of the transparency requirements in the 3rd package
- *4. What level of detail, e.g. level of harmonisation, do you expect from the CEER vision paper on a conceptual model for the European gas market? For example:*
 - *a. Do we need a definition of an EU-wide gas day? If yes, what should this definition be?*

Yes, to complement a daily balancing regime and to simplify arbitrage market areas we do need an EU-wide gas day. EURELECTRIC stresses that in the first instance it should be evaluated whether it is relevant to harmonise the gas day with the power day⁵.

- *b. How deep should the "reach" of the EU gas market model be, i.e. should it encompass DSOs? Is there a trade-off between vertical depth (i.e. including all levels of national gas*

The gas target model should principally extend to the wholesale market and TSO operations that are required to enhance competition and facilitate integration of wholesale markets. However, DSOs should also be included to the extent their interactions with TSOs have an important role to play in ensuring shippers are provided with accurate forecast and allocation of their portfolio of offtakes as they will not be governed by European network codes.

Upstream, LNG and storage should not be included directly but their interactions with TSOs will have an important role to play in ensuring transparency of supply side fundamentals and the flexibility shippers require to balancing their portfolios.

⁵ In those countries where gas and power day are already harmonised, a thorough analysis should be carried out before deciding to implement changes to the gas day.

- *5. Which areas or aspects of the gas market should be affected by the target model and what are the constraints for such a model?*

The gas target model should affect those aspects specified in the 3rd Package where ACER and ENTSOG are required to develop Framework Guidelines and Network Codes. This principally applies to: capacity allocation and congestion management, balancing, harmonisation of tariff structures, transparency and interoperability.

- *6. Which areas or aspects of the gas market should be excluded from the target model description and left to national/regional decision making*

We believe that the target model should be an instrument to guide the development of regional markets in a coherent and consistent way towards the achievement of the overarching objectives, as set out earlier in this paper (i.e. ensuring secure, competitive and more flexible gas supplies through the development of liquid and transparent wholesale markets). The target model should focus on the essentials which need to be made convergent so as to pave the way for more robust and liquid wholesale markets. In our view, it should not be the aim of the target model to provide an over prescriptive and straight jacket approach. In this instance, issues such as the harmonisation of tariffs should not be the focus of this target model but the tariff structure and the procedures to determine tariffs and cost allocation mechanisms should be closely considered.

- *7. What are the options for integrating the currently fragmented European markets? Are there any existing models you would like to recommend? In case your answer is yes, we would be interested to learn about the features of this model and if there are also any draw-backs in this model in your view.*
 - *a. Should we merge balancing zones to create cross border or regional balancing zones or market areas? How many balancing zones does Europe need and how big should they be?*

EURELECTRIC does not yet know the extent to which market areas/balancing zones can merge in an efficient and cost-effective way. Harmonisation of core market operations through Framework Guidelines and Network Codes will encourage co-operation and integration, which in turn will make it easier to determine the physical limits to which integration is possible and to implement it.

Furthermore, the implementation of the 3rd Package will stimulate competition within market areas, and price convergence between market areas, regardless of whether integration takes place or not.

- *b. Is the coupling of market areas as it is being developed in European electricity markets appropriate for gas?*

EURELECTRIC points out that gas and electricity markets differ for several reasons, including:

- physics of energy flows
- hourly trading and real time balancing vs. daily balancing, storage and linepack
- indigenous generation vs. transportation from geographic reserves
- data complexity associated with hourly trading and real time balancing
- physical congestion easier and quicker to relieve in gas than electricity
- greater use of merchant interconnection in gas

Market coupling of day-ahead electricity wholesale markets is seen in the power sector as the most efficient tool to optimise available cross-border capacity, thereby increasing the number of trades between the market coupled areas and achieving an optimal level of price convergence. It cannot be automatically assumed that the same benefits will arise in the gas markets, where price convergence has progressed through other means and the lead times for trading gas are much longer. Whilst EURELECTRIC strongly advocates in favour of market coupling for the integration of electricity wholesale markets, we believe that a thorough assessment should be carried out to identify and evaluate the pros and cons of introducing market coupling in the gas markets and to demonstrate that market coupling is the most pragmatic way to increase liquidity and bring about price convergence across a number of specific neighbouring market areas (e.g. less developed markets). In the meantime however, work should continue on the development of Framework Guidelines and Network Codes in line with Madrid Forum discussions and as set out in the 3rd Package.

Conclusions

Concluding, we acknowledge that the current consultation has initiated a fruitful debate among regulators, the EU Commission and gas stakeholders. We believe that any development on the target model will not happen overnight and should be centred on broad and transparent discussions among all Madrid Forum participants. Therefore, EURELECTRIC looks very much forward to attending and contributing to the workshops that will be organised during 2011.



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