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E.ON Position on

Gas Balancing Rules on European Gas Transmission Networks Draft Pilot Framework Guideline

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1 General Remarks

E.ON welcomes and appreciates the ERGEG consultation on the Pilot Framework Guideline on gas balancing rules. The development of EU-wide principles for a network code for gas balancing is seen as crucial to fulfill the requirements outlined in Article 8.6 of the Gas Regulation 715/2009.

E.ON appreciates the concept of defining a target model while giving TSOs time and interim measures to implement it. Gas markets in Europe have been developing differently and the NC should take into account these different stages of development. However, we believe it is crucial to minimize regulatory risk by setting out clear rules and a well defined roadmap for full implementation that – after a certain time – will lead to a pan-European level playing field.

The following section answers in detail the questions set out in ERGEG's consultation paper.

2 Specific Remarks

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?

Generally we agree with the problems identified in this section of the document. In particular we see the urgent need to comply with the legal requirement of Art 21 of Regulation 715/2009 to implement a market based balancing, as the Madrid Forum concluded as early as 2006.

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?

We do not see any additional policy issues.

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?

E.ON believes in the virtue of a pan-European balancing regime. To implement this will inevitably lead to amendments in national balancing rules. The European NC should be as detailed as possible to avoid different interpretations of its rules in different member states.

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 appreciate the concept of defining a target model while giving TSOs time and interim measures to implement it. Gas markets in Europe have developed differently and the NC should take into account these different stages of development. However, we believe it's crucial to minimize regulatory risk by setting out clear rules that – after a certain time – will lead to a pan-European level playing field.

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?**

With regard to the time needed to fully implement a target model, we do not believe in a one-size-fits-all approach. As long as (a) the target model is clearly defined, (b) TSOs are incentivized to progress on their way to it and (c) NRAs have a well laid out plan on how to get to the target model, including the approval of any necessary deviations on an interim basis, we are confident that the target model will be implemented in due course. ACER should take over the responsibility and competence to monitor and ensure NRA progress.

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?**

The FG is generally sufficiently specific in section 3. With regard to nomination procedures, standardization is clearly needed. Any standardization should aim at enabling the standard nomination regime to facilitate cross-border trading of flexible gas.

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?**

Article 21 of the Gas Regulation 715/2009 sets all the principles for a future European balancing regime. Our below comments are comments on how it should be reflected in the balancing NC.

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?

Yes, we think it is necessary to have a harmonized approach to the extend possible.

The implementation of a target model harmonizing the roles of TSOs and network users in every European transmission system will lead to a natural merger of balancing zones wherever and whenever transport capacity between adjacent systems is not constrained. It will hence lead to an integrated European gas market. Regulatory assistance may then be required to ensure there is

sufficient investment in network infrastructure and in removing any barriers to the development of the economically most efficient balancing zones–including those covering multiple Member States.

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 the principle that TSOs only need to have a residual role when it comes to balancing. And we think that the proposed target model will generally lead to a reduced need of balancing activities. However, a balancing regime will only be efficient if it facilitates (a) the secure and reliable operation of the relevant transmission system and (b) a competitive market. Daily balancing regimes reduce barriers to market entry but may require an increase in certain TSO balancing actions. On the other hand, hourly balancing regimes can place onerous obligations on network users and therefore represent a serious barrier to entry, but at the same time tend to reduce TSO activity due to the network users' obligation to match inputs and off-takes every hour. Thus it is important to emphasize that minimizing the TSO balancing role should not be viewed as a goal in itself.

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?**

Technical within-day constraints might be necessary for some networks to cope with certain flow patterns at system entry or exit points that are potentially relevant for system stability. These technical constraints may be ramp-up/down restrictions or scheduling obligations. They should not be imposed on certain (groups of) network users but on users of certain input and off-take points (for example interconnection points), and on certain flow patterns (increase or decrease of flows within certain time periods [MW_t-MW_{t+1}<x] OR [MW_t-MW_{nom}<x]). In any case, within-day constraints shall not impose penalties (or 'adverse' financial incentives) on deviations between inputs and off-takes.

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

Yes, but only as an interim measure until such time as there is insufficient information on individual portfolio balance status. It should be secured that the pre-determined off-take profile reflects the real off-take as much as possible.

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?**

TSOs should certainly use linepack as a system service to enable network users to balance their inputs and off-takes over a day. However, TSOs should not be allowed to sell this service as additional balancing product in the target model. They should, instead, use it exclusively to reduce the need for balancing actions during the day without a specific charge.

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

This should be an interim step: once network users have access to intraday flexibility, robust and frequently updated information about their portfolio balance, and time to act on the intraday market, they do not need tolerances any longer.

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?

Additionally to a real time information on the system balancing status that is needed to assess the demand-supply situation and, hence, the market prices, the following data on the individual balancing status should be provided by TSOs (in cooperation with DSOs) in the target model:

- Non-Daily-Metered (NDM) sites: Forecast of the consumption of NDM sites using standard load profiles including a within day update of the forecast.
- Daily Metered-sites: In order to balance their portfolio intraday information on the shippers' individual balancing status and on the system balance status has to be provided.

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

Continuous information on system balance status (system supply-demand balance/ line pack) is crucial to assess intraday prices. In a daily balancing regime it gives network users a signal for the right time to act on the market to balance their expected (e.o.d.) volumes.

Like other market sensitive data, network user should treat TSO data, especially forecast information such as end of day volumes, with a degree of caution. Care must be taken to ensure that TSOs do not provide misleading information to the market because of the potential for financial gain arising from any balancing incentive mechanisms agreed with the relevant NRA.

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

Undoubtedly there are considerable costs involved to provide within-day information on individual portfolio status, and TSOs will surely be able to estimate this. Ultimately, end-consumers will have to bear these costs. The benefits, however–the creation of a competitive, integrated European gas market which will lead to a decrease in market prices–are much harder to quantify. However,

alternative regimes with sub-daily balancing intervals trigger even bigger investments in information systems because the frequency of information provision has to be consistent with the balancing period. In (potentially) hourly balancing regimes, the TSO has to provide at least hourly information on individual portfolio balances to enable network users to comply with the tight time constraints.

Balancing periods

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

The draft FG asks ENTSOG to oblige TSOs to introduce daily balancing. But they allow for within-day constraints in the target model without specifying what these might be. We therefore do not think that ERGEG has made its target model clear enough.

We strongly believe, however, that the benefits of daily balancing and the creation of liquid and competitive markets will only arise if the whole market and, hence, all sources of flexibility including demand side responses, are integrated in a consistent daily balancing regime. Therefore, a clear 'pure daily' balancing system should be described in the target model of the framework guideline. Only with clear formulations, a Europe-wide harmonization of balancing regimes can be achieved.

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?

The only relevant additional balancing option that ERGEG has not explicitly included in its target model is probably the so called continuous balancing that is going to be implemented by Dutch GTS in 2011. This model is clearly a courageous step towards market based balancing. Nevertheless, its core concept is based on potential hourly cash-outs and as such demands huge investments in information provision without giving network users and market participants the time to deal with supply-demand imbalances over a sufficient period of time.

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.

Yes, we think it is necessary to harmonize balancing periods. We believe that implementing a target model, harmonizing balancing periods and the other key features of a balancing system in every European transmission system will lead to a natural merger of balancing zones wherever and whenever transport capacity between adjacent systems is not constrained. Hence, it will lead to an integrated European gas market. Regulatory assistance may then be required to ensure there is sufficient investment in network infrastructure and in removing any barriers to the development of the most economically efficient balancing zones – including those covering multiple Member States. [please see Q8]

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

The balancing period shall be a day. End-of-day balancing is in general preferable to sub-daily balancing, as it allows network users more time and flexibility in adjusting their imbalance such that they can respond to commercial cash out incentives in the most efficient manner. Daily balancing is also less operationally complex for network users and is (or should be) aligned with the timeframe for capacity sales and gas supply/trading. Transaction costs attached to end of day balancing, therefore, are lower and as such it can be expected to encourage new entrants and market liquidity, thereby making wholesale gas markets more efficient and competitive.

Even with a constrained line-pack situation, daily balancing is possible: the underlying, physical flexibility does not depend on the balancing regime–it does not increase with hourly balancing as it does not decrease when daily balancing is applied. The difference between both regimes is that rather than individual network users the TSO buys and sells gas within-day. However, unlike individual network users, TSOs will do so to a lesser extent and therefore more efficiently due to the system netting or portfolio effect. Moving away from sub daily / hourly balancing bears the risk of higher balancing costs for some network users – those with flexible supply sources and/or sufficient diverse portfolios to cope with hourly balancing. We believe, however, that these costs will be partly offset by the same shippers being able to offer flexibility to the TSO or to the market. Overall, intraday flexibility needs and balancing costs will decrease though because TSOs will procure balancing gas more short-term and therefore more network users will be able to offer flexible gas due to better forecasting abilities than on long term balancing markets.

Instruments like restrictions on ramp-up/down rates at system relevant input or off-take points, or scheduling obligations might be necessary to effectively minimize any potential abuse of a daily balancing regime by network users.

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

We agree to the part of the target model that asks for daily balancing. We do not agree with its approach to giving NRAs the discretion to introduce non-specified within-day constraints. E.ON would like to urge ERGEG to clearly define the framework within which ENTSOG will be able to set detailed rules. And we do believe that, although this framework might consist of a variety of clearly defined interim measures including those on the balancing period, the target model should define a pan-European NC on balancing with a daily balancing period.

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)?

As most of the bigger European networks already operate under a daily balancing regime (UK, Italy, France, and Germany) we do not expect huge costs from a European perspective. E.ON cannot quantify individual TSOs' costs though.

TSO buying and selling of flexible gas and balancing services

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

The documents describe the policy options generally correctly and we also agree with their assessment. One additional feature is missing though. In practice, the policy options "stand alone balancing market" and "periodic tenders" are designed in a hybrid form: although the TSO drawing lead time as well as the product procured may be short term (i.e. within-day or day ahead) the "stand alone balancing market"-rules require some form of longer term commitment from market participants. This longer term commitment–for example a withdrawal lead time of 8 hours for every offer on the standalone market (e.g. in the new Dutch model), offer of capacity option payments additionally to commodity exercise payments (e.g. in Germany)–excludes both demand side response sources of flexibility and smaller portfolios from the balancing 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?

The target model for TSO procurement of balancing gas should be the intraday wholesale market and TSO should be obliged to procure balancing gas exclusively via the wholesale markets once liquid short term gas markets (both intraday and day ahead) have developed. Without prejudice for provisions to cope with emergency situations, the transmission system operator shall be obliged to exclusively procure system balancing energy on the wholesale market used by other network users. Together with the commercial incentive for network users to balance their end-of-day volumes through within day actions on the same market, this – the TSO action – will trigger within-day market activity and will lead to liquid within-day markets. Within-day markets in turn not only play a crucial part in the price formation of spot and forward wholesale markets, they also offer a low cost source of flexible gas and hence ease market entry. TSO action on the wholesale market will therefore create sufficient liquid within-day or day-ahead markets; it is crucial that TSOs start to procure balancing gas to the extent possible as soon as possible on this market instead of waiting for this market to develop independently.

To enable (some) TSOs to cope with within-day network constraints, there is a need of physical[1], and/or locational[2] products to be offered next to the title transfer product in order to provide the transmission system operator with the means necessary to procure system energy immediately and/or at a specific input or off-take point within the system. This will also enable the TSO to avoid any potential abuse of the system by network users.

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

Taking into account the overall costs – TSO procurement and individual network user procurement – the implementation of the target model will save costs in each Member State.

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

If the respective National Regulatory Authority, the transmission system operator and stakeholders deem the wholesale market not yet liquid enough to guarantee the procurement of the required system balancing energy, the transmission system operator shall have the option to procure balancing energy through day-ahead and within-day products on a standalone balancing platform separate to the trading market or through a periodic tender process on a balancing platform. The term of a tender shall not exceed one year-ahead. Access to this procurement process shall be subject to non-discriminatory and transparent rules. Capacity option payments may be offered additionally to commodity exercise payments. The transmission system operator shall have the incentive to phase out any procurement of balancing energy outside the exchanges used for wholesale market trading. This will help concentrate liquidity and improve the overall transparency of TSO balancing actions,

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?**

No, it is perfectly possible for TSO balancing actions to be integrated within the exchanges used for wholesale market trading. Physical and locational and other products that meet the operational need of each TSO can be offered on these exchanges. If NRAs approve separate balancing platforms, there is a risk of fragmenting liquidity and introducing potential barriers to future merger of balancing zones, especially across national borders.

[1] 'Physical' in this context means a counterparty commits to physically inject or take-off or a certain volume of gas physically at particular times

[2] 'Locational' in this context means the obligation of a counterparty to inject or off-take gas at a specific entry/exit-point of the system

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?**

See questions no. 24 ff.

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?**

See question no. 26

Imbalance Charges

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

Again, the assessment of the policy options is generally correct. However, if the TSO has not needed to procure (or sell) gas on the wholesale market or a balancing platform, cost reflectivity cannot be the governing principle when calculating balancing charges because there are no balancing costs incurred by the TSO (see p. 49 of the Initial Impact Assessment). Costs for providing line-pack should not be covered by the balancing regime but by general network tariffs. Instead, a market cash-out price ("system average price") when the TSO did not take balance actions in a particular direction should be installed. To incentivize network users to trade out their positions rather than accept this market cash-out price, an uplift of a certain percentage of the system average price should be introduced.

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.**

The reasons given in the draft FG and its accompanying documents are comprehensive: non-harmonized charges or cash-out prices will inevitably lead to arbitrage. Whereas arbitrage as such is beneficial as long as it leads to a convergence of market prices, it distorts the integration of European gas markets when imbalance charges are not based upon marginal market prices.

Question 32: What are your views of the target model? In particular, please provide your views on:

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

In this case, imbalance charges should not be applied and the cash-out price should be based upon an average market reference price. This is because if there is no procurement of balancing gas by the TSO, there are no costs borne by the TSO and hence, the system was kept in balance by the sum of all actions of network users. Hence, any cash-out prices would not need to incentivize network users

to behave differently from how they behaved; as a consequence, the cash-out price should be a market neutral price for settlement/ reconciliation purposes only.

- What the imbalance charge should be based on, if it is applied when the TSO has not taken a balancing action,

See above.

- Whether imbalance charges should be dual or single priced,

In balancing regimes where there is no cash-out when the TSO is procuring balancing energy dual pricing does not make sense as network users may have contributed to the system imbalance within-day but are perfectly balanced or even "helping" the system at the end of the day.

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

Cash-out prices shall be based on the marginal price of all sell and buy actions of the transmission system operator (system marginal price, SMP) during the balancing period or on the day ahead of it. This will ensure cost reflectivity to the extent possible; it will incentivizes network users to balance their inputs and off-takes without relying on the TSO because they will be able to beat the cash-out price through their own actions on the within-day wholesale market; and it will avoid undue barriers to new market entry.

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

Unlike implementing most of the complementary features of our preferred target model, there are no costs involved in implementing a marginal market price cash-out regime.

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

The proposed interim steps are reasonable.

Cross-border cooperation

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

The main and most efficient cross-border cooperation is not mentioned explicitly in this section of the document: It should be and is at least partly already currently led by network users transporting

(flexible) gas from balancing zone A to balancing zone B according to within-day price spreads between A and B.

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

The assessment of the policy options in this section clearly lacks one fundamental point: Regardless of which specific policy option mentioned, the need for the reservation of cross-border transport capacity to complement the economic balancing with the physical balancing will arise. If network user X nets a long position in balancing zone A with a short position in balancing zone B, the relevant TSOs will have to transport gas from A to B; if neighboring TSOs exchange bids and offers for flexible gas in their markets, they will have to transport the procured gas to their market (the same applies to the use of regional platforms or the use of OBAs for balancing rather than reconciliation purposes). The reservation of transport capacity, however, for TSO cross border balancing actions will neither be necessary nor beneficial for the development of liquid trading markets and for the integration of European gas markets. This is because network users, if able to access cross-border transport capacity, will react to within-day price differences and transport flexible gas from A to B. The market will deliver the same effect more efficiently and TSOs will be able to concentrate on their residual role.

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?**

As correctly described in the document, OBAs are mainly used to allow TSOs to manage the fluctuations in cross-border gas flows, which may occur as a result of differences in gas qualities or steering differences. For the reasons described above, this purpose should not be extended to any form of TSO-TSO balancing.