

Vision Paper for a conceptual model for the European gas market – Call for Evidence

Joint IFIEC Europe and CEFIC response to this CEER call for evidence
(Ref: E10-GWG-70-03)

General remarks

1. IFIEC Europe & CEFIC welcome the opportunity to respond to this CEER call for evidence on a vision for a conceptual model for the European gas market (ref. E10-GWG-70-03);
2. A secure, efficient and competitive market is essential to large industrial energy consumers that IFIEC Europe & CEFIC represent. IFIEC Europe & CEFIC believe that the establishment of a liquid market will generate reliable outcomes and therefore welcomes a market-based approach of the ERGEG target model. Nevertheless, it is clear that many of the 27 EU Member States have an illiquid or non-functioning gas market. Here an interim period is required during which specific conditions apply to protect grid-users against the risks that stem from illiquid market conditions. In cases in which there is no market place at all, the Transmission System Operator (TSO) should be responsible for providing alternative solutions.

Issues

1. What are in your view the main goals to be aimed at by the gas target model beneath the high-level policy goals set out by the 3rd Package?

As a point of first principles both IFIEC Europe and CEFIC would like to highlight that a fully implemented EU gas target model should in the future enable the following market outcomes:

- Efficient prices resulting from gas supply and demand
- Competitive prices for the European industrial energy consumers in order to secure employment
- Equal and non-discriminatory access to gas infrastructures
- Efficient investments ensuring that infrastructure costs do not escalate (affordability)

Therefore the main goals to be aimed at by the gas target model are to provide a framework that enables the above market outcomes throughout Europe. We believe the following proposals are key to achieving those market outcomes;

- **Consumer is linked to gas supply via entry-exit system, by:**
 - Physical entry upstream: capacity goes with the customer (if capacity is earmarked), or through auctions, with strict UIOLO
 - Physical exit downstream: capacity goes with the customer
 - Virtual entry and exit midstream
- **Consumer has access to liquid trading hub, in order to:**
 - Source gas
 - Source flexibility
 - Enjoy price transparency
- **Gas sourcing includes:**
 - Full supply vs. portfolio approach

- Long-term vs. short term products
- Acceptable and predictable gas quality
- **Consumer is exposed to market based balancing regime, which:**
 - Puts all available system flexibility at disposal of all network users for free (linepack)
 - Excludes penalties which are not justified by underlying costs
 - Provides all necessary information on portfolio as well as system balance

2. What are in your view the major developments and anticipated changes in the European gas market (on national and international level) and where would a target model bring added value? Including:

a. The role of long term capacity contracts in the future European gas markets;

- The target model should allow long-term capacity contracts, but it is important that every market participant has the same chance to become a contract partner of - and have access to - such long-term contracts.
- In some countries existing long-term contracts hamper cross boarder trade. **Any future gas target model should ensure that significant capacity is available for short term contracts in order to break market foreclosure and allow competition in the market.**
- Long-term capacity contracts provide industrial consumers with necessary visibility and security for their investments.
- **Adequate** market capacity with effective "Use It Or Lose It" mechanisms including further secondary capacity markets.

b. The role of hubs / gas exchanges.

- Reiterating the response in Q1, liquid gas exchanges should generate efficient prices and should be a result of supply and demand.
- Every market participant should have easy and flexible access to a liquid gas exchange
- Liquid gas exchanges provide price transparency

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.

Transparency;

- Full market transparency disclosure to all market participants is essential.
- We therefore ask CEER to take into account the joint IFIEC Europe and CEFIC response to the ERGEG consultation on existing transparency requirements for natural gas in November 2010

Balancing Regime based on following principles;

- Supporting a liquid market based system and development of competition
- Available flexibility of the system i.e. line pack should be available to all network users disposal for free
- Most cost efficient
- Compliant with "polluter pays" principle
- Imbalances charges based on single price method (symmetric price for those that help to reduce/contribute to system imbalance)
- Cost related incentives to keep the system in balance

- Simple and transparent
- Good forecasting abilities must lead to lower balancing costs
- Transparency including supply (3rd package) through near real time information
- Participation of industrial consumers at the market for balancing energy

Capacity Allocation Mechanisms (CAM)

- Pro-rata systems and “first come first served” benefit only the major supply side players.
- Auctions, as currently structured, need to be thoroughly assessed, because they may lead to overvalued prices and speculation on regulated assets (i.e. supremacy of some suppliers and lack of liquidity).
- An alternative could be by a mechanism where capacity “rights” go with the customer. This is the concept ERGEG recommended for storage capacities presented in Madrid Forum. This merits considering for wider gas purchasing, even though the procedural challenges are more complex. IFIEC believes that such a mechanism would provide all suppliers with access to capacity.

Gas quality must be guaranteed which provides the ongoing (investments in) production processes including in the chemical industry that uses gas as raw material

A **Decoupled Entry-Exit** model is the preferred transport system.

Network tariffs should be cost reflective, transparent, non-discriminatory and linked to the actions taken by the TSO.

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 a EU-wide gas day? If yes, what should this definition be?

- Yes, a uniform start and finish time for a EU-wide gas day is needed.
- As well as uniformity with regard to nomination and re-nomination procedures (including lead times), the unit of energy (MWh) etc. should be addressed.

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 markets) and horizontal depth (i.e. integrating balancing zones cross border)?

- Yes, the EU gas market model should also encompass DSOs.
- However we recognise that in the interim period, whilst progress through the implementation of the target model is made, TSOs should firstly be treated as a priority. This is justified as TSOs are interconnected with other EU member markets whereas DSOs are at the end of the line.

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 target model should enable the constitution of a European-wide market, with interim steps that start at a regional level. It should define the harmonization rules required to guarantee cross-border interoperability. We believe these are the crucial first steps that will then allow the market to develop.
- The European gas networks as well as gas prices should be influenced by the target model. Networks should be developed so there is no hindrance by bottlenecks and hence inefficient networks do not affect market prices.
- Storage and LNG facilities should be considered as crucial infrastructures in the same way as the gas transportation network. Therefore regulated in the way they must offer third party access in the way they allocate capacity.

- Suppliers must have access to the whole logistics chain in order to structure competitive offers.
- Transportation and access shall be treated separate from the commodity trade; large industrial consumers shall have the possibility to arrange own gas transport (e.g. “light shipper status” today already existing in some EU Member States)

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

- Some decisions should be left to national authorities in order to take into account the specific situation of each country (network investment, available line-pack, storage, available sources).
- For example:
 - Capacity allocation within a country.
 - Details of balancing regime (level of free tolerance, TSO Information System, etc).
- However the terms and conditions within EU member states should be comparable in order to safeguard a level playing field. There should be some regional co-ordination to ensure that the European framework is safeguarded.

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 drawbacks 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?

- The target model is to achieve a single European liquid market area, however an interim period is required to take into account national specificities.
- We should first concentrate on reducing the number of balancing zones to a strict minimum within each country.

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

- Coupling of market areas should only occur when costs are merited through the improvement of competition.
- Markets zones should only be coupled when there is sufficient liquidity with all options being analyzed under the scope of their cost-benefit ratio.
- We do however feel that the coupling of electricity markets helped to kick start market integration. This model could also be a driver for the development of a regionally integrated gas market.
- For IFIEC and CEFIC members that use significant amounts of gas for both feedstock and firing (heat and power generation), it is essential that gas quality aspects are fully investigated when considering to couple (national) gas markets.