

October 2010

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

IFIEC Europe and CEFIC response to this ERGEG consultation document  
(Ref: E10-GNM-13-03)

### General remarks

1. IFIEC Europe and CEFIC welcome the opportunity to respond to this ERGEG consultation on the draft pilot Framework Guideline for Gas Balancing Rules on European Gas Transmission Networks (ref. E10-GNM-13-03 and 04);
2. A secure, efficient and competitive market is essential to the large consumers that IFIEC Europe and CEFIC represent. IFIEC Europe and CEFIC believe that the establishment of a liquid market will generate reliable outcomes and therefore welcomes the ERGEG target model that is based on market principles. Nevertheless, it is clear that many of the 27 EU Member States have an illiquid or non-functioning gas market. In these situations an interim period is required, during which specific conditions apply to protect grid-users against the risks that stem from illiquid market conditions, as a transition towards the target model. In cases in which there is no market place at all, the Transmission System Operator (TSO) should be responsible for providing alternative solutions.
3. We strongly believe that the main issue with regard to gas balancing is the risk in balancing a portfolio. This risk can lead to extreme costs at a certain hour or day and may prevent market players (especially small shippers and new entrants) from participating in a certain gas market and/or investing in that market. Since the infrastructure and level of market development differs significantly among EU Member States, we believe that the creation of one overall balancing regime for the EU is neither realistic, nor necessary. However, harmonisation of balancing regimes is critical for the realisation of the Integrated European Energy market (IEM). The main purpose of harmonisation under the target model conditions should be to minimise the aforementioned risks for participants in the market.
4. The conditions for a harmonised balancing regime should be:
  - a. Uniformity with regard to the gas day, nomination and re-nomination procedures (including lead times), the unit of energy (MWh), etc.
  - b. Stimulating and facilitating new entrants to participate in the gas market(s) by encouraging a contractual scheme that allows new entrants to rely on (an independent third party) balancing shipper;
  - c. Stimulating network users to contribute to the integrity of the network;
  - d. Stimulating the development of – and contributing to - a liquid day-ahead and within-day gas market place;
  - e. Transparent and clear settlement of imbalance costs with fair, cost-reflective prices;
  - f. TSOs have the availability of instruments in order to maintain the system integrity under all conditions;
  - g. Sufficient, well-timed and reliable near real time (about 10 minutes delay) information should always be available;

- h. There should be an incentive to reduce the number of balancing zones to a strict minimum. Exceptions to this rule only in case of justified reasons like physical congestion, to be judged by Acer;
- i. A necessary condition for balancing zones is the availability of liquid market places for balancing products that can be provided via Exchanges, OTC's or intraday markets.
- j. The network user must have access to transportation capacities between the virtual exchange point and the exit point;
- k. The system should be regulated and monitored in such a way that any type of abuse is prevented.

## Issues

Following our more general comments please find IFIEC Europe's and CEFIC's response to the more detailed questions

### **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?*

IFIEC Europe and CEFIC fully agree with the statement that balancing zones often favour incumbents and create obstacles for new entrants. The limited accesses to flexibility as well as the limited access to cross border transport capacity are vital advantages for any incumbent. These advantages help both maintain and gain market power in certain market zones where the incumbent is dominant and are therefore the pivotal supplier during many hours of the year.

IFIEC Europe and CEFIC agree with the target model that network users should have the ability and the incentive to balance their own gas inputs and off-takes as well as the ability to contribute to the balancing of the grid. The most efficient way to do that is through a market based system. In many existing balancing systems we see penalties for network users when they are long or short compared to the nomination. Penalties however raise costs but do not contribute to a more efficient working system, as network users cannot always prevent imbalances from occurring. Market incentives are more efficient and effective in that respect.

*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?*

IFIEC Europe and CEFIC understand that the scope is to be defined by issues of cross border nature between market zones / balancing zones. Hence, this also might be within national borders where more than one balancing zone exists. If this understanding is correct, we agree with the scope. IFIEC Europe and CEFIC are in favour of creating one balancing zone per country and a subsequent gas (balancing) market place.

IFIEC Europe and CEFIC understand that the two main objectives of the pilot framework guideline are to move towards greater integration of EU energy markets and market-based balancing regimes. We agree with these objectives of the target model. We believe in markets as the most efficient way to generate reliable and efficient outcomes.

In the EU in 2010, we still face national markets with incumbents dominating these national markets. The interest of network users -in particular of the new entrants and the end-users of natural gas- is the access to sufficient transport capacity and the availability of flexibility instruments. The gas balancing framework guidelines must ensure a level playing field for all balancing parties, including new entrants.

*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?*

IFIEC Europe and CEFIC believe that the creation of one overall European Balancing Regime is not realistic as long as separate balancing zones based on regional or national infrastructure characteristics, as well as different market conditions, continue to exist. However, harmonising balancing rules in the different markets is highly crucial to the realisation of the IEM.

As balancing regimes in different regions and Member States differ a lot, harmonisation must lead to the amendment of national balancing rules, however the amount of amendment is difficult to point at this moment. Member States cannot be expected to change their infrastructure in an inefficient way just to meet a certain level of compatibility. Any amendments of national balancing zones should deliver incentives for market parties to invest in infrastructure (for instance storage) and instruments to optimise their portfolio. Harmonisation of balancing rules should mitigate risks of trading across borders and provide incentives for new entrants and small market players to optimise their portfolio in materialising cross border opportunities, such as price arbitrage opportunities.

*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?*

IFIEC Europe and CEFIC believe it to be inevitable that a transitional period will be required to bridge the transition from the current situation in a specific balancing zone to the agreed harmonised target model. Market parties need to adapt to the new regime by changing the portfolio policy, in investing in instruments, and in changing the portfolio management. In some cases new infrastructure has to be planned and realised. In other cases a market place has to be established and / or developed. These situations would justify interim steps, which MUST BE subject to the National Regulatory Authorities (NRA's) approval in order to prevent any type of abuse. In order to prevent these interim solutions creating obstacles for realising the target model, it is necessary to establish a clear set of criteria with a set of interim solutions that must be fulfilled. NRA's must then report these interim solutions to ACER, and to have ACER to monitor compliance of the interim solutions within the criteria set.

*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?*

After the network code is adopted, taking into account that interim steps are part of the code, an implementation period of 12 months should be sufficient in order to take the measures as mentioned under question 4, including ICT-operations and training of staff, traders, process engineers, etc. A shorter period is not likely to be realistic; a longer period is not to be preferred from a market development perspective. If a market place is totally lacking, an implementation period of 12 months is too short. In those cases, a maximum period of 3 years seems to be appropriate however dependent on the available infrastructure and required investments. A longer period will discourage the sense of urgency and will lead to extra (transition) costs.

*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?*

As imbalance is the difference between the nomination and the actual realisation, nomination procedures are the starting point and should be taken into account. An example is the harmonisation of the gas day and hence the closing hour of the day ahead nominations.

*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?*

IFIEC Europe and CEFIC agree with the proposed policy objectives. We would like to put emphasis on the need for sufficient, well timed and reliable near real time information. Without this information, a liquid market will never develop and network users will not be able to contribute to the integrity of the system in an efficient way. The out coming costs for imbalance would than be inefficient and gas balancing would remain a risk for network users, hence not leading to the so preferred supranational gas market.

## **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?*

IFIEC Europe and CEFIC believe a harmonised approach with regard to the roles of TSOs and network users is essential. In order to develop a liquid gas / balancing market, the trading of flexibility should preferably take place on that market and as little as possible through TSOs instruments. TSOs at the opposite side of a border might have different opinions and interests, e.g. as a result of the differences in their infrastructures (available line pack, access to storage, etc.). These phenomena require principles, set in rules that are transparent and harmonised.

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

In order to develop a liquid gas / balancing market, the trading of flexibility should preferably take place on that market with as little as possible TSOs interference. However, the TSOs should maintain responsibility for system integrity and hence should manage the residual imbalance that is resulting after market parties have traded their imbalances in the market. If a liquid day-ahead and within-day market place has not developed yet, actions should be taken aiming at such a development. For the interim or transition period, other mechanisms shall be put in place, in which the TSOs might have a larger role. The first alternative is a market based balancing system where parties sell or buy gas with the purpose of balancing their portfolios. The last alternative should be the TSO contracting the required flexibility for a year, as this is very inefficient and hence raises the costs of network users. The only party making a large profit in this situation is the incumbent having access to the required flexibility.

*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?*

In general IFIEC Europe and CEFIC are not in favour of imposing within-day constraints to whatever party. The system must be based on the principle that users who are causing the imbalance also pay their share of the imbalance costs (polluter pays principle). In case of constraints, for example when particular users (like highly modulated users) generate constraints or extra-costs on the network, then the TSO or National Authority should be able to impose particular operational and financial rules to these users. These constraints must be temporary.

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

IFIEC Europe and CEFIC believe this interim step will not function. Balancing against a pre-determined off-take profile only refers to a situation of non-metered customers. An important condition for a balancing system is that players can anticipate imbalances. Network-users need to have access to (near) real time information.

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

IFIEC Europe and CEFIC believe that line pack can be made available to the market, but only with the restriction that the risks with regard to the integrity of the system (security of supply) are not put at stake. It MUST BE the NRA that judges the approval of such conditions. The provision of line pack should not be mandatory as in some Member States the line pack might be short and too risky to be provided to the market. There shall be a difference between the months of the year, with the winter months reflecting the tightest situation.

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

The provision of free tolerances should remain. As a target, IFIEC and CEFIC wish that a liquid market will be in place for all balancing zones and thus enables each user to buy all the flexibility needed. However, the TSOs benefit from their own flexibility tools (for example line pack) that they use to maintain the network within acceptable limits. This operational flexibility is part of the network normal usage and should remain provided for free to network users, either as individual tolerance or as a pooled tolerance (for example in the case of the cumulative system).

## **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?*

Two types of information are crucial:

1. Portfolio of the network user: sufficient, well timed and reliable near real time information on the portfolio of the network user (Portfolio Imbalance Signal), available for the specific network user. This user may decide to contract a shipper/supplier that manages his

- portfolio and hence the shipper/supplier will receive the required information with regard to the portfolio from this user;
2. Network integrity: sufficient, well timed and reliable near real time information on the TSOs network system as a whole (Network Imbalance Signal), available for all network users.

In the information requirements it is important for the TSO to know at every moment the position of the network (pressure, imbalance), as it is important for the network user to know its own position.

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

The TSO should be the independent network operator, facilitating all network users. That is their core business and should be realised in a fair, non-discriminatory and transparent way. If network users require information that is necessary for their operations, this information should be generated and be made public, unless it can be made clear that the network user is not entitled to receive the information. The extra costs for the generation and distribution of this information will be shared by the network users from the benefits they have. This is not a matter of disadvantage versus benefit.

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

See our answer to question 15.

## Balancing periods

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

IFIEC Europe and CEFIC support the recommendation of ERGEG to reduce the balancing actions required by the TSO as much as possible. In line with ERGEG we conclude that this may best be achieved only through a liquid day-ahead and within-day gas market, sufficient information for market participants and imbalance charges which provide network users with appropriate incentives to balance their portfolio.

Moreover, we recommend starting closer examinations (for example) relating to the operational part of the policy options. In these examinations, questions can be addressed like the role large end-users can play on the imbalance market, or will the imbalance market in fact be dedicated for the incumbents or large energy companies/shippers?

*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?*

Not at first sight, but it is likely that a deeper assessment of the policy options will create additional options.

*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.*

Harmonization of the balancing system could facilitate more cross border capacity and stimulate international trade. Moreover larger balancing zones will provide lower flexibility- and balancing costs.

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

IFIEC Europe and CEFIC believe that one single balancing period for all regions does not reflect reality. In this regard, we would like to draw attention to the KEMA study on Methodologies for Gas Transmission Network Tariffs and Gas Balancing Fees in Europe carried out on behalf of DG TREN<sup>1</sup>. Here it was concluded that most Member States indeed formally apply for a daily balancing period. However, it was also stated that it is important to clearly differentiate between the formal and effective balancing period, in particular as various countries have combined a notional daily balancing period with additional hourly and/or cumulative constraints. According to the study this may effectively create a system that more closely resembles the use of hourly or at least sub-daily rather than daily balancing periods (ref. page 93). In some zones end-users prefer daily balancing; in other zones a cumulative system is more appropriate. The optimal system should in principle allow both options as

<sup>1</sup> <http://www.energy-community.org/pls/portal/docs/736177.PDF>

the right balancing period will depend for a large part on the different physical circumstances in different zones. The guiding principles of the decision process for the balancing period are:

- Supporting a liquid market based system
- Must encourage the development of competition
- Network-users are primarily responsible for imbalances
- Available flexibility of the system (i.e. line pack) should be available to all network users disposal, for free
- Most cost efficient
- Avoiding free riders behaviour
- Level playing field for all network users
- Compliant with 'polluter pays' principle
- Cost related incentives to keep the system in balance
- Simple and transparent
- Not hindering cross border trade of commodity and flexibility

For those zones where market based balancing systems are lacking enough liquidity and/or are dominated by incumbents, a cost based system controlled by the regulator might be a cost efficient interim solution.

*Question 21: Do you agree with the target model? (Please explain your answer).*  
See our answer to question 20.

*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)?*

A very interesting question that needs to be investigated in more detail by a transparent and broadly based study. In this stage this question is beyond the knowledge and expertise of IFIEC Europe and CEFIC.

## **TSO buying and selling of flexible gas and balancing services**

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

TSOs should not procure balancing gas in a balancing system in which network users are responsible for their imbalance and have to take actions to avoid imbalances charges. In this system the TSO acts as a service provider to settle imbalances between players. Procurement of balancing gas by TSOs is only for situations where they act as suppliers of last resort to safeguard the integrity of the grids.

*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?*

See answer question 23.

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

This question is beyond the knowledge and expertise of IFIEC Europe and CEFIC.

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

No response

*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 considered to be an alternative if a liquid gas market is not in place.

*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?*

Key is a minimum role of the TSOs in gas balancing and maintaining the network integrity. The measures taken should be efficient resulting in low risks and efficient costs. In that perspective the TSO should not be forbidden, but incentives should be placed to ensure the TSOs act efficiently.

*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?*

These steps could be different for each individual country; we therefore leave it to representatives in individual Member States to respond.

## **Imbalance Charges**

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

IFIEC Europe and CEFIC favour the wholesale market procurement as the gas balancing than contributes to the liquidity of the gas market, whereas a separate gas balancing market or platform does not. Options such as negotiated contracts and tendering procedures are not preferred and only an interim option as long as a liquid gas market is not in place.

*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.*

Example: symmetric prices (short and long)

Yes, IFIEC Europe and CEFIC favour a system in which methods for calculating imbalance charges are harmonised. This will restrain market participants for arbitrage. To avoid network users abusing any information provided by the TSO (for keeping the system in balance), the NRA's should have proper remedies.

*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 cases where the TSO does not need to take balancing actions, the balancing price should reflect the gas price on the wholesale market, without any mark-ups.

- *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;*

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

The imbalance charges should be based on a single price method; the price that network users receive for helping to reduce the overall system imbalance should be equal to the price network users have to pay that contributes to the overall imbalance. This price should be based on a marginal price established by an independent transparent and liquid platform like an exchange.

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

The ultimate goal is to keep the total costs of the balancing system as low as possible. Moreover the costs and benefits of the system have to be shared on a fair basis. An estimation of the total costs and benefits is difficult and could be different for each country.

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

As an interim step, ERGEG proposes to charge the imbalance via a proxy, which is based on the prices in different wholesale markets with the inclusion or a price uplift. IFIEC Europe and CEFIC are reluctant to support this proposal, because the proxy can substantially deviate the costs incurred by the TSO to recover the balance. Price differences could also cause undesired incentives like arbitrage.

## **Cross-border cooperation**

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

IFIEC Europe and CEFIC agree with ERGEG that cross-border co-operation would be beneficial to encourage market integration and that further work is to be done by TSOs to develop proposals for cross-border balancing first and to analyse the costs and benefits of such proposals.

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

See answer to question 35.

*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?*

This question is beyond the knowledge and expertise of IFIEC Europe and CEFIC.