

Position Paper

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

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General Remarks

The German Association of Energy and Water Industries (BDEW) represents 1,800 members of the electricity, gas and water industry. In the energy sector, we represent companies active in generation, trading, transmission, distribution and retail.

We welcome the opportunity to comment on the ERGEG Consultation Paper.

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?

The target model as a result of developments in the creation of market design and framework guidelines shall lead - within the foreseeable future - to a deep, liquid, interconnected single EU gas market where gas can flow freely without barriers across national borders to those markets where price signals attract supplies based on an efficient and transparent price formation reflecting supply and demand fundamentals.

The target model shall be based on standardized, harmonized, consistent and detailed infrastructure access regulation across the EU and lead to trading at few, interconnected or “coupled” trading points (hubs) given that those hubs maximise the liquidity. Framework Guidelines and Network Codes shall be detailed and may allow for national deviations only to the extent that the general objectives of the target model are not impacted.

An effective process and market reflective investment incentives and an attractive and stable investment climate to ensure appropriate and cost effective transportation grid evolution must be part of a target model.

- 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;**
 - b) the role of hubs / gas exchanges.**

Major EU gas market developments over the coming two decades are expected to be the following:

- Despite increasing energy efficient use and challenging policy scenarios, **gas demand in the EU is expected to grow** in the coming decades¹ driven mainly by economic growth and increased use in power generation, at the same time some national scenarios assume stagnation or even a slow reduction of gas demand.
- In conjunction with an increasing production by renewable energy sources, the **gas power plants can increasingly act as a “buffer”** in terms of balancing purposes: gas power plants are one source for control energy purposes because of their high flexibility.
- New gas power plants are amongst the **quickest ways to meet near and long term CO2 emission targets**. As a consequence, market rules have to appropriately combine long-term security of gas supply needs with short-term flexibility requirements for gas-fired power plants.
- **Decline of domestic production** from existing fields will trigger the need for new LNG and pipeline gas imports from global sources thereby triggering the need to expand or modify the transportation grid layout – in those cases where congestion management procedures like UIOLI and secondary capacity markets are not sufficient to overcome congestions.
- New potential domestic production from **unconventional resources** may partially replace the decline from existing fields long term and would likely require modifications to the existing grid.
- The need of a better **integration of peripheral gas markets** within the EU or at the borders of the EU will require cost-effective infrastructure solutions which enable reverse flows.
- The European gas market will, driven by a growth of LNG regasification capacities, increasingly become integrated part of a **global gas market** where prices fluctuate reflecting global gas demand and supply.
- Long-term gas supply contracts and short-term gas supplies will continue to complement each other in the gas market.

¹ IEA World Energy Outlook 2010

- Long-term contracts will increasingly be delinked from the oil price. This will lead to the necessity to hedge price risks gas-to-gas and hence trigger and strengthen the development of a reliable forward market.
- Competition between gas suppliers will continue to increase at all levels along the value chain.

A deep, liquid, interconnected EU gas market with few trading hubs as envisaged for the target model will address the above listed developments:

- It can **provide “security of demand”** for new gas supply investments both within the EU and from global sources. Thereby the target model increases **diversity and security of supply for EU consumers**.
- Prices for gas which develop based on demand and supply in a transparent manner will facilitate the use of gas where its economic value is the highest.
- A deep, liquid, competitive EU gas market is likely to have **positive effects on gas demand and security of supply** as gas will be easily accessible for existing and new consumers and at prices which develop in an efficient market. Accessibility to and economic supply of the low CO₂ primary energy natural gas will contribute to economic growth in the EU.
- A **deep, liquid EU gas market** is likely to reduce the share of gas supplies sold based on long term contracts and, hence, the need for long term capacity contracts. However, adequate long term bookings will still play a role where they are needed for supporting long term import contracts. In addition, for new gas supply projects which require significant pipeline investments, long term capacity bookings may be required to underpin the investment.

The European sustainability efforts and the associated low carbon targets pose a number of questions that should also be considered when discussing the European target model for 2015, these are for example:

- The future role of gas in the European energy mix.
- The viability of larger investments in gas transmission infrastructure and their regulatory treatment, especially with respect to the applicable depreciation periods.
- Usage of the gas transmission and storage infrastructure to efficiently transport and store methane converted from hydrogen which was generated by renewable.

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.

Key elements of the gas market target model should be:

- **Minimize need to arrange for transport** for both gas suppliers and traders: this means the integration of entry / exit and thus also balancing zones along the physical layout of the existing pipeline grids to the extent firm Entry/Exit capacity will not need to be reduced significantly. The market area integration in the German gas market in the past years has shown the complexity and challenges, but also the feasibility of such a process.
- **Standardize transport arrangements at remaining entry/ exit points:** The recent and ongoing Comitology, Framework Guideline and Network Code development processes on standard capacity products, allocation procedures of primary and secondary capacity, congestion management and on a harmonized balancing regime will need to lead to a single set of rules across the EU.
- **Effective integration of day ahead trading at remaining hubs,** inter alia by applying adequate congestion management procedures.
- Any rules to be adopted need to take into consideration the **technical and market characteristics of gas transportations**. Harmonization is not a goal itself. We should always assess the feasibility and related costs and benefits.
- Generally, during the process of change the **sanctity of existing contracts** must be ensured, i.e. the requirement to adapt existing contracts to new legally binding rules should not be used to change existing capacity reservations as to volume or duration. Sanctity of contracts is an important principle in the gas industry to ensure a sound investment climate that is pivotal to long term security of supply in the gas industry. However, as from the entry into force of this Guideline, it should be ensured that:
 - Any new primary capacity should be allocated according to the new rules
 - Contracted but unused capacity should be offered to the market.

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?

A CEER vision paper on the conceptual model for the European gas market should contain the following elements:

- a description of the objective and the scope of the gas market target model,
- key elements of the model (see responses to question 5 and 6), and
- a path with milestones to reach the target model.

BDEW strongly supports the definition of a EU-wide Gas day and it should be further evaluated if it could be useful to harmonise the gas day with the power day.

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)?

The EU target model should include rules for transmission grid access at the level of wholesale markets. Regulation for downstream distribution grids will likely need to be designed by national regulators such that they do not contradict with rules for the upstream grids / markets. Horizontal integration should not be hampered by issues of vertical integration.

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 third European Energy Package prescribes the development of network codes covering 12 areas. BDEW strongly supports the development of a complementary target model within the foreseen deadline of mid 2011 to provide guidance on the design of framework guidelines and guidelines (Annex to regulation (EC) No 715/2009). Guidance should especially be provided on major aspects of:

- The design of entry / exit transport systems
- Capacity allocation methods including auctions of primary capacities as well as secondary capacity allocation.
- Harmonized requirements for shippers to **balance their portfolios on a daily basis** and harmonized processes and products to balance imbalances based on market mechanisms.
- Availability of the relevant data for shippers based on the requirements of the balancing system design.
- Criteria for a potential integration of entry / exit zones are integrated across borders including inter-TSO compensation mechanisms.
- **Responsibilities for the expansion of transport capacities**, incentives to invest into gas infrastructure and the responsibility of regulators to set timely incentives for continued maintenance and expansion of the transportation network

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

The scope of the target model should exclude:

- Regulation of the precise level of tariffs: given the complexity and often political sensitivity of this aspect, a harmonized regulation of tariff levels can become a barrier for a fast track development towards the target model. However, tariff structures, procedures to determine tariffs and cost allocation mechanisms should be harmonized to increase transparency. Furthermore, certain measures such as capacity auctions require clearly defined tariff elements (e.g. auction base rates) across borders.
- Control energy products which are not part of a market based balancing regime and are offered by suppliers to TSO's to balance their systems.
- The market for secondary transportation capacity should likewise not be regulated but commercial freedom to market such capacity shall be maintained.

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?

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

Before analysing those methods, the objectives to integrate the currently fragmented European gas markets should be defined under consideration of the following aspects:

- price convergence
- efficient utilisation of existing infrastructure
- portfolio effects and ease of handling for shippers
- synergy effects with other markets, especially the electricity market

Based on these objectives, the implementation of the following measures should be discussed and their costs and benefits should be assessed with all involved stakeholders. The analysis should include an assessment whether temporary or permanent measures are more cost-effective. The overall costs shall not exceed the overall economic welfare of the respective measure.

Explicit Day-Ahead Auctions / Hub-to-Hub Products

One possible measure to enhance integration of market areas is the non-discriminatory and transparent offer of additional short-term capacity. To this aim in particular day-ahead capacity should be created or reserved. In this option it is allocated via explicit capacity auctions.

To further facilitate these capacity auctions and hub-to-hub trading, any new capacity between market areas can be bundled. The requirement to adapt existing contracts to new legally binding rules should not be used to change existing capacity reservations. Sanctity of contracts is an important principle in the gas industry to ensure a sound investment climate that is pivotal to long term security of supply in the gas industry.

Such hub-to-hub products combining exit and entry capacities into one product are currently being developed at a number of European cross-border points. Examples are “Link4Hubs”

connecting the Dutch, North-German and Danish gas markets and the bundled capacities offered on “Capsquare” connecting the Belgian and North-French gas market. The experiences being gained with such pilot projects can feed into the development of Europe-wide definitions.

Implicit Auctions/ Market Coupling

Another possible measure is the introduction of implicit auctions/ market coupling. Up to now, such an approach has not been implemented in the European gas market. In order to carry out a qualified discussion on this, a joint understanding of the main mechanisms needs to be developed under consideration of the following elements:

- Both CMP and CAM framework guidelines are going to be applied in 2011 and their effects should be studied first, before suggesting another congestion management measure.
- Efficient integration into the existing production, import, and storage markets.
- Potential of this congestion management measure to collect the relevant investment sums to remove the congestion physically.

Merging of Balancing Zones

A third option for integration of adjacent markets is a full merger of balancing zones. This is considered as a complex measure. Experiences in Germany have shown that too large zone sizes may lead to adverse effects on the amount of firm capacity. In order to guarantee freely allocable entry/exit capacities additional control energy, load flow commitments or alternatively infrastructure investments are needed.

In addition, this option requires full harmonization inter alia of the balancing regimes in both markets. Joint efforts of Member States, regulators, TSOs and network users are required to achieve this.

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