



# **Impact assessment for Guidelines on Good Practice for Gas Balancing**

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## 1. Introduction

EREGEG finalised its guidelines for good practice for gas balancing (GGPGB)<sup>1</sup> in December 2006 and submitted it to the European Commission (EC) as its advice on interpretation of Article 7 of Regulation (EC) No 1775/2005 of the European Parliament and of the Council of 28 September 2005 on conditions for access to the natural gas transmission networks (the 'Gas Regulation'). The GGPGB were developed through a transparent consultation process and input was received from a wide range of stakeholders including transmission system operators (TSOs), shippers, suppliers, traders and customers.<sup>2</sup>

EREGEG has recommended to the EC that the GGPGB be made binding in some form to help ensure effective implementation of the necessary documents across the EU.

The EC proposed that EREGEG produce an "Impact Assessment" (IA) on the likely 'impact' of making the GGPGB binding in some form.

This IA has been prepared by EREGEG. It sets out the potential impact of making the GGPGB binding in some form. It is recognised that the final text of any binding requirements in relation to gas balancing may differ from the text of the GGPGB prepared by EREGEG. This IA uses the final version of the GGPGB published by EREGEG in December 2006 to assess the potential impact.

## 2. The GGPGB

### 2.1. Purpose of the GGPGB

The purpose of the GGPGB is to provide more detailed guidance to both TSOs and the relevant National Regulatory Authority (NRAS) on the design of gas balancing mechanisms. The GGPGB are designed to help ensure that gas balancing mechanisms maintain the safe, secure, efficient and reliable operation of the network and that the rules are based on objective criteria and designed and applied in a fair, non-discriminatory and transparent manner.

The GGPGB were developed following an initial consultation on CEER's gas balancing principles in 2005 which concluded that guidelines needed to be developed to provide more clarity on the design of gas balancing mechanisms. Following an extensive and transparent consultation process (including through the Madrid fora) the GGPGB were finalised by EREGEG in December 2006. EREGEG indicated that the GGPGB should be implemented by 1 April 2007 – but that where this was not possible they should be in place at the latest by 1 July 2007.

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<sup>1</sup> Ref : E06-GFG-17-04

<sup>2</sup> All documents published by EREGEG in developing the GGPGB (including responses received to consultation documents and draft versions of the GGPGB) are available on the EREGEG website [www.ereg.org](http://www.ereg.org)

## 2.2. Overview of the GGPGB

The GGPGB provide guidance to NRAs and TSOs in the design of gas balancing mechanisms including on:

- The criteria for deciding on the appropriate balancing period;
- The design of imbalance and penalty charges;
- Allowing the trading and pooling of imbalance positions;
- The design and provision of tolerance levels and services;
- The information on balancing that should be provided to the market and individual shippers; and
- The harmonisation of balancing rules.

The GGPGB also set out the respective roles and responsibilities of NRAs, TSOs and network users and general requirements in relation to gas balancing – for example in relation to confidentiality.

## 3. Assessing the impact of the GGPGB

This IA assesses the potential impact of making ERGEG's GGPGB a binding requirement in some form. It does not discuss different options for how the GGPGB could be made binding (e.g. whether they should become annexed guidelines to the Gas Regulation) as this is a matter for the EC.

Identifying the quantitative impact of making the GGPGB binding is not straightforward. This is because it does not set out explicit requirements for change (e.g. to invest or implement new operational arrangements) that can be assessed in terms of the costs and benefits that could be expected to arise – although where possible potential costs could be incurred this is highlighted. Given the nature of the GGPGB ERGEG does not expect that implementation of the guidelines will lead to significant costs for TSOs or market operators.

### 3.1. Options for requirements in relation to gas balancing

Gas balancing has a crucial role to play in underpinning an effective, efficient and competitive market in gas. If gas balancing mechanisms are not designed appropriately and/or there is a lack of access to flexibility tools and services or lack of transparency then real barriers to entry to a market can be created. There may also be negative consequences for security of supply. The design of gas balancing mechanisms can also have a significant impact on customers as balancing costs can represent a significant proportion of the costs faced by customers. It is important therefore that there are appropriate requirements in place for gas balancing.

There are three broad options for the “requirements” that could be put in place:

- Rely on the existing requirements (i.e. Article 7) in the Gas Regulation;
- Keep the GGPGB as voluntary guidelines; or

- Make the GGPGB a binding requirement in some form.

Article 7 of the Gas Regulation (Article 7 – paragraphs 1-7) sets out high level requirements for the design of gas balancing rules and imbalance charges. However, there is little detail either on the explicit requirements or on guidance to NRAs/TSOs on the issues that need to be considered in making decisions on developing gas balancing mechanisms.

EREGG's view is that the absence of sufficient detail on the requirements for gas balancing has led to problems in some countries – including that:

- the incentives faced by network users do not result in efficient balancing actions – for example incentives may be poorly designed which can increase the residual balancing actions taken by TSOs and the costs faced by customers;
- there is a lack of transparency in the gas balancing mechanism which makes it difficult for network users to take timely and effective decisions regarding the balancing positions;
- there is a lack of access to flexibility tools and services at a reasonable cost to allow network users to manage their imbalance positions effectively; and
- In some cases the way in which costs/penalties are calculated for imbalance can represent a real and significant barrier to entry to a market - particularly when coupled with a lack of transparency and poor access to flexibility tools and services.

There are also significant differences in the way in which gas balancing mechanisms are designed across the EU. It is not clear that all of these differences can be explained by network differences and/or the level of development in the gas market in each country. There is a need therefore for greater clarity and consistency in the design of gas balancing mechanisms to help ensure effective market integration.

***EREGG's view therefore is that the existing binding requirements are not sufficient to ensure that, across the EU, gas balancing mechanisms are designed in a way that maintain the safe, secure, efficient and reliable operation of the network and that the rules are based on objective criteria and designed and applied in a fair, non-discriminatory and transparent manner.***

***EREGG's GGPGB focus on providing more detailed guidance to TSOs/NRAs in these areas.*** The majority of respondents to EREGG's consultation on gas balancing welcomed the proposal to develop more detailed guidelines on gas balancing.

At present there is no scope within the existing legislative framework to bring forward additional binding requirements for gas balancing. ***The GGPGB were therefore developed as a set of voluntary guidelines.*** There is significant evidence to suggest that the use of voluntary guidelines does not lead to sufficient and consistent implementation of necessary requirements. For example, the work that EREGG has done on monitoring compliance against its voluntary guidelines for gas storage shows that despite a period of over 2 years, there still remain significant problems of non-compliance across the EU.<sup>3</sup> This is despite the publication of several reports on the implementation of the guidelines which clearly identified

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3 Details of EREGG's work on monitoring compliance against its storage guidelines are available on its website.

areas of non-compliance. The lack of recourse for NRAs to take action against those failing to implement significantly undermines the effectiveness of voluntary arrangements.

***EREG's view therefore is that in crucial areas of the regulatory framework – such as gas balancing – there is a need for binding requirements that provide sufficient detail and guidance on the arrangements that should be put in place. NRAs should also be provided with the necessary powers to take effective and appropriate action in instances of non-compliance.***

EREG's GGPGB provide an appropriate basis for the necessary additional binding requirements for gas balancing although it is recognised that there is a need to review the detailed text to ensure that any legislative proposals are appropriate.

### **3.2. Assessing the specific requirements in the GGPGB**

This section of the IA looks in more detail at some of the specific requirements in the GGPGB and identifies the potential impact that making them binding would have in terms of helping to ensure:

- *security of supply;*
- *non-discrimination;*
- *transparency;*
- *consistency and market integration;* and
- *that barriers to entry to markets are not created and the development of competition is facilitated.*

#### **3.2.1. Security of supply**

Well designed gas balancing mechanisms have a crucial role to play in maintaining security of supply and this is one of the overarching objectives of the GGPGB. This will be primarily be achieved through ensuring that there appropriate incentives in place both for network to efficiently manage their imbalance position and for the TSO in its function of residual balancer of the system. The GGPGB provide guidance on the design of imbalance and penalty charges that can be levied on network users – clearly identifying the need that they should be designed in a way to provide appropriate incentives to balance their inputs/offtakes of gas. The GGPGB also provide guidance on the treatment of balancing costs and incentives for TSOs in their role as the residual balancer of the system.

The GGPGB also clearly identify the respective roles and responsibilities of both TSOs and network users in this respect – providing clarity about what is expected of each party.

The GGPGB do not mandate a particular balancing period but rather identify the criteria that need to be assessed in coming to decisions on this issue. One of the key criteria is the operational capabilities of transportation system to balance the system (which has a key impact on security of supply).

### **3.2.2. Non-discrimination**

It is crucial that the design of gas balancing mechanisms do not lead to discrimination between network users. One of the overarching objectives of the GGPG is that balancing rules are designed and applied in a fair, non-discriminatory and transparent manner. The requirement for non-discrimination is reiterated within the GGPG for key aspects of a balancing mechanism including imbalance charges, the way in which TSO procure gas for balancing actions and how any costs incurred by TSOs are charged back to network users.

The GGPG also require that in order to ensure non-discrimination, balancing rules (including rules relating to imbalance charges) should be equally applied by a TSO to its own commercial operation and related undertakings (where part of a vertically integrated company) as to third parties.

### **3.2.3. Transparency**

Transparency is crucial to the effective functioning of gas balancing mechanisms – for example a lack of transparency will make it difficult for network users to take timely and efficient decisions about their imbalance position which could increase the overall costs of balancing the system and possibly security of supply. A lack of transparency will also increase the level of risk faced by network users which could create barriers to entry to markets and therefore the development of effective competition. The GGPG therefore outline the minimum high level requirements for balancing transparency – both in terms of the information that is made available to the market and also individual network users. The GGPG recognise that the specific and detailed information needs for balancing may differ across markets and therefore require that TSOs develop “information templates” in consultation with network users (and subject to the approval of NRAs).

The GGPG require that information must be provided promptly and on the same time scale to all network on a non-discriminatory basis. It allows for network users to request that TSOs do not publish information on the aggregate use of balancing services if this would harm the commercial interest of the user(s). However, this decision can be reviewed by the relevant NRA who can require that the information be published.

The GGPG also require that where charges do exist for the provision of information they should be approved by the NRA and made public by the TSO. This is to ensure that any charges that are made are reasonable and do not prevent network users from obtaining the information they need to take timely and efficient decisions about their imbalance positions.

It is also important that balancing mechanisms are developed in a transparent way and against objective criteria. The GGPG explicitly require that the development of balancing rules should be subject to appropriate consultation with market participants and based on objective criteria and analysis.

### **3.2.4. Consistency and market integration**

One way of achieving greater consistency in balancing mechanisms across different countries would be to set out prescriptive rules that should be followed by NRAs and TSOs. However, this runs a risk of creating a lack of flexibility and/or inappropriate regulatory

burden (see below). Nonetheless, greater consistency between balancing mechanisms can help facilitate market integration and competition. The GGPGB therefore require that NRAs and TSOs shall endeavour to harmonise (at least make compatible) balancing regimes and streamline arrangements in particular with regard to:

- tolerances;
- imbalance charges; and
- balancing periods

The GGPGB also require that where there remain differences between interconnected networks a report shall be produced to identify the key areas of difference and their impact, including on trade and efficient operation of the markets – and where appropriate an action plan should be developed by TSOs to identify the development of measures to improve compatibility.

### **3.2.5. Ensuring the development of competition and avoiding barriers to entry**

Well designed balancing mechanisms will help to underpin the development of effective and efficient markets. The GGPGB generally require that the design of balancing mechanisms should not expose network users to undue levels of risk that could give rise to creating barriers to entry. In particular, the GGPGB specify that network users should have access to appropriate information, adequate re-nomination procedures and flexibility tools/services so that they can manage their risk efficiently – taking into account the relevant characteristics of the balancing mechanism including the balancing period. The GGPGB also explicitly state that imbalance and penalty charges should not hamper the entry of new market entrants.

The GGPGB also allow for arrangements to encourage competition by helping network users to manage risk more effectively and efficiently. This includes the use of provisional allocations in the calculation of imbalance charges (including that these should be settled as soon as possible); and allowing the use of trading and pooling of imbalance positions.

#### *Ensuring flexibility and appropriate regulatory requirements*

Detailed guidelines on gas balancing must strike a balance between ensuring that mechanisms are designed in an appropriate way whilst not creating an undue regulatory burden and/or giving rise to an inappropriate level of costs. They must also allow for appropriate flexibility to ensure that mechanisms reflect national needs whilst at the same time making sure that barriers to market integration are not created by differences across countries. ERGEG's GGPGB have developed in a way that tries to ensure that this is the case – for example on the issue of:

- the appropriate gas balancing period the GGPGB set out the criteria that need to be considered in making decisions rather than specifying an EU consistent period which could lead to significant impact on costs (and possibly security of supply); and
- information the GGPGB set out the minimum high level requirements but leaves it to TSOs to develop appropriate templates for the provision of information in consultation with network users (and subject to the agreement of the relevant NRA) rather than specify in detail exactly should be published across the EU.

### **3.3. Potential costs of the GGPGB**

The main area where making the GGPGB binding could lead to additional costs being incurred is the requirements on transparency. The GGPGB set out the minimum high level requirements for the information on balancing that should be made available by TSOs both to the market and individual shippers. It also requires that information should be made available on a website and in the national language and in English. Depending on the existing situation in each country meeting the high level requirements that are in the GGPGB could give to TSOs incurring some additional costs – for example in IT costs. However, ERGEG does not expect that these costs would be material in relation to the benefits that would be expected from improved transparency – for example more efficient balancing actions (which should reduce the costs of balancing for all parties and therefore ultimately customers).

In addition, the GGPGB allow some flexibility in terms of the specific transparency requirements that are put in place to recognise the specific situation in each country – although the information arrangements that are put in place should be developed in consultation with network users and any charges, where they exist, for provision of information should be approved by the relevant NRA.

### **3.4. Other potential impacts**

#### **3.4.1. Environmental impacts**

ERGEG does not expect that making the GGPGB binding in some form would have any particular or significant impact – positive or negative – on the environment.

#### **3.4.2. Health and safety**

ERGEG does not expect that making the GGPGB binding in some form would have any particular or significant impact – positive or negative – on health and safety although the Guidelines require that gas balancing mechanisms are developed in a way that ensure the safe operation of the network.

#### **3.4.3. Distributional effects**

During ERGEG's consultation on developing the GGPGB a number of respondents, particularly new entrants and larger customers, expressed significant concerns that the way in gas balancing mechanisms operated in some countries created barriers to entry. The GGPGB, by providing explicit guidance on the design of gas balancing mechanisms, should help to ensure that these barriers are minimised (and hopefully removed) and that arrangements are fair, transparent and non-discriminatory. This could lead to a reduction in the relative risks (and potentially costs) faced by new market entrants – although it is not possible to quantify this impact. ERGEG considers that given the views expressed by network users and the beneficial impact that improved balancing arrangements could have on the development of competition that any distributional effects in this respect would be positive.

### 3.5. Risks and unintended consequences

The possible risks and unintended consequences of the GGPGB are:

- *That security of supply is undermined* – well designed gas balancing mechanisms have a crucial role to play in helping to maintain security of supply therefore the GGPGB should have a positive impact in this area. Concerns were raised by a small number of respondents to the draft version of the GGPGB that allowing network users to trade and pool their imbalance positions could undermine incentives to balance and therefore security of supply. ERGEG indicated in its explanatory note to the final GGPGB that pooling and trading of imbalance positions can provide network users with additional ability to manage the level of risk they are exposed to – which may be particularly useful where access to flexibility tools and services is limited. However, the GGPGB also indicate that such arrangements should not be introduced if they do undermine incentives to balance and the safe, secure and economic operation of the network;
- *That there are significant unforeseen costs* – the GGPGB don't impose prescriptive requirements for gas balancing that could lead to significant (and potentially unforeseen) costs – for example in the form of new investment in the network and/or new operational commitments. Therefore ERGEG's view is that there is very little risk that making the GGPGB binding in some could lead to significant unforeseen costs; and
- *That it creates an unnecessary regulatory burden and/or a lack of flexibility* – the GGPGB provide high level guidance on the design of gas balancing mechanisms rather than prescriptive rules that could lead to unnecessary regulatory burden and/or a lack of flexibility to reflect national needs.