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### Framework Guidelines on Gas Balancing

Dear Fay,

RWE Supply and Trading welcomes the opportunity to comment on the above consultation.

We have been impressed by the extent to which the Impact Assessment reflects the discussion within the ad hoc expert group, and how clearly and thoroughly it sets out the policy options. ERGED are to be commended for this and should regard this as a benchmark for future consultations on framework guidelines.

We share ERGED's view that the underlying objective of this framework guideline is to facilitate gas trade across and support competition within the EU. We believe this will lead to greater liquidity within market areas and organic and efficient integration, which as a major European energy trading company we welcome.

In order to achieve this objective it is important for balancing arrangements to be harmonised wherever possible (to prevent inefficient arbitrage) and to be designed so as to encourage new market entrants. As the number of market participants increases a TSO's ability to balance its network directly diminishes and so it becomes more efficient for users to take primary responsibility for balancing (through strong financial incentives to balance their position), leaving the TSO with a residual role.

As competition increases users can be expected to make more efficient use of the flexibility available within market areas (and in neighbouring market areas) and to create new physical and virtual sources of flexibility. As a result input and output flows will react more frequently and quickly to changing market circumstances, making it harder for TSOs to understand how market participants are managing to balance the system (or not as the case may be).

We believe ERGED's target model of an end of day balancing regime, where TSOs take residual balancing action in the wholesale market as necessary thereby setting the marginal price incentives against which users imbalances are

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settled, is the most appropriate framework for supporting competition and facilitating trade across the EU

We recognise that implementing such a target model may pose challenges for some TSOs whose networks have limited linepack or high transit flows. It is appropriate therefore for the framework guidelines to include measures that can be taken by these TSOs as interim steps towards achieving the target model.

To help better inform stakeholders of the extent to which the target model is achievable and how long interim steps may persist, we believe it would be helpful for TSOs to release more detailed information about the amount of linepack within their system, and the timescales within which they have to react to developing system imbalances. At present, whilst it is widely understood that some networks are more restricted than others, stakeholders have no way of comparing the extent of such differences or fully appreciating the challenge that implementing the target model may be for some TSOs.

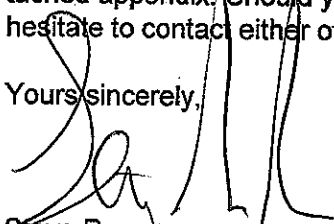
We also believe that NRAs should consider introducing financial incentives for TSOs to procure more residual balancing gas from the wholesale market and/or to minimise overall residual balancing costs. Experience in GB shows that incentives were instrumental in changing the TSO's understandably cautious approach to balancing and helped the TSO to better understand the full extent of the flexibility the market is able to provide.


Whilst at this stage it may appear very difficult for some TSOs to adopt the target model we believe that progressive implementation of the measures included in the 3<sup>rd</sup> package and harmonisation of operations under European network codes will result in greater competition and innovation. Consequently the sources of flexibility and methods by which users and TSOs balance the system can be expected to be significantly different to those currently employed, making the target model more realistically achievable.

As competition and harmonisation increases the market is likely to reveal where the desire for integration lies and what the limit of balancing zone boundaries are. TSOs may also discover that harmonisation can be achieved more easily using a joint approach with neighbouring TSOs which should lead to integration, market coupling and regional system operations occurring organically.

Our response to the questions included in the consultation is included in the attached appendix. Should you wish to discuss this in more detail please do not hesitate to contact either of us.

Yours sincerely,

  
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Head of Gas Market Design

  
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## Appendix

### **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?*

The problems identification chapter of the Impact Assessment represents an excellent summary of the issues and problems caused by differing EU balancing arrangements. We are not aware of any additional problems.

*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 agree with the scope and objectives of the pilot framework guideline. However we think that the objectives should also state that all TSOs will ultimately be expected to implement the target model. Interim steps should be what they say they are, and NRA approval of a TSO implementing an interim step should come with sufficient justification as to why such an interim step is necessary, along with a plan and time-scale of actions the TSO will be expected to take to achieve the target model.

*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?*

The European network code for gas balancing will inevitably require individual Member States to amend their national balancing rules.

The European target model, and interim steps, should be defined in the framework guidelines with sufficient detail and clarity to allow ENTSG to draft a network code. Bearing in mind the European network code will need to be approved through comitology we still expect it to be a relatively high level document, which will need to be transposed into the detailed contractual terms and conditions contained within individual TSO network codes. However the European network code needs to provide sufficient detail about how the six core operational principles contained in the framework guidelines (information provision, roles and responsibilities, balancing periods, imbalance charges, TSO balancing actions, cross border cooperation) are expected to work in practice. For example we would expect a European network code to explain the principle of how neutrality costs will be apportioned, which TSO balancing actions feed into cash-out prices and what information about input and offtake flows will be provided to users when and by who.

As the European network code will inevitably not be able to address all operational principles in detailed legalistic terms we think it is also important for ENTSG, in conjunction with ACER and stakeholders, to issue guidelines accompanying it. These would address any areas of the code which TSOs considered still to be ambiguous, or where there were known differences of interpretation, citing real life examples and drawing on the specifics of TSO network operation in different Member States.

Also NRAs and TSOs should not desist from progressing concrete changes to market design or harmonisation whilst European network codes are being developed, provided it is consistent with the interim steps and target model described in the framework guideline and would enhance competition and market integration in the meantime.

*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?*

Yes although see our comments in Question 2.

*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?*

Whilst it may be helpful for ACER and the Commission to spell out their aspirations for implementing the target model across Europe by a certain date we do not think it is sensible at this stage to try and enforce an arbitrary timescale. It is important to recognise the considerable differences across Member States that currently regarding TSO networks, TSO/DSO interaction and measurement systems, market structure and competition. Also the amount of operational, systems and legal resources required to achieve the target model in some Member states should not be underestimated. We believe that 2015 is a reasonable aspiration for full implementation but even this date will be challenging for some TSOs.

That said it may be appropriate to enforce a timescale for TSOs to ensure their balancing arrangements comply with the interim steps described in the European network code and, as previously stated, we would expect regulatory pressure to be applied to TSOs to ensure they progress expeditiously towards implementing the target model.

*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?*

We think the purpose and policy objectives are sufficiently specific but would like to see principles on nomination procedures included here and elsewhere within the framework guidelines. Article 8.6.i) of the Regulation states that the network code on balancing rules should include rules on nomination procedures. Whilst they are also related to the issue of capacity allocation and congestion management we think this framework guideline is the most appropriate place for them.

Within the target model all cross border entry/exit flow nominations should constitute, or trigger, an equivalent capacity nomination. As part of the target model TSOs should be required to include standard nomination deadlines day ahead, renomination cut off times, maximum renomination lead times and appropriate renomination principles (e.g. not being able to renominate less than what has already been delivered) within the European network code..

*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 contains a number of important qualifications regarding how balancing rules are to be designed. Firstly they have to reflect "genuine system needs taking into account the resources available to the TSO". Secondly information provided to users has to reflect the "level of information available to the TSO and the settlement period for which imbalance charges are calculated". Finally imbalance charges shall be cost reflective "to the extent possible" and "shall avoid cross subsidisation between network users and shall not hamper the entry of new market entrants".

As such the Regulation appears to recognise that whilst Member States should strive towards harmonisation and streamlined structures compromises (e.g. regarding implementation timescales) and trade-offs between conflicting principles (e.g. between exact cost targeting and facilitating new market entry) may be required.

We believe the policy objectives and the six core operational principles within the framework guidelines sufficiently address these compromises and trade offs by clearly defining the principles of the target model, the interim steps which are subject to NRA determination and by not enforcing a fixed implementation date.

#### **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?*

We firmly believe that in competitive markets with multiple network users it is most efficient to incentivise users to balance their portfolios, leaving the TSO with a residual role to balance the system where network users have not done this in aggregate and where short term operational constraints prevail.

In order to benefit from such efficiency across the EU we believe it is necessary to have a harmonised approach to network user and TSO balancing roles. TSO balancing actions, which drive the incentivisation of users, also need to be undertaken in a consistent and ultimately harmonised manner.

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

Reducing the need for TSOs to undertake balancing activities is both desirable and efficient. However it should be noted that implementing the desired end of day balancing target model in networks with limited linepack is likely to result in an increase in TSO balancing activity, at least in the short term.

Reducing TSO balancing activities should not be considered an absolute objective therefore as it is theoretically possible, and in our opinion quite likely, that increased TSO balancing activity (or the threat of it) will elicit an efficient response from the market, resulting in entry/exit flows flowing in a profile which better matches the system's requirements.

For example the regular actions of the TSO buying gas in the morning and selling gas in the afternoon to meet the systems diurnal profile may encourage parties with physical gas to frontload flows at the beginning of the day, as this would give them more options to sell gas to the TSO (whilst still meeting their end of day commitments) or into the wholesale market (in response to the marginal buy price created by the TSO buy actions).. Also psychologically some users prefer to initially adopt

slightly long positions in an end of day balancing regime, as it is considered harder and riskier to correct a short position as the day progresses because time and liquidity conspire against you. TSOs in restricted networks could also procure gas on the gas exchange day ahead to effectively front load the system for the diurnal morning peak (selling any surplus as the day progresses). This may also create incentives for market participants to adjust their physical flows within day in a way which complements the TSOs required flow profile and contributes to day-ahead liquidity and system security.

*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?*

With the exception of technical restrictions on ramp rates (such as those which exist in the GB market for CCGTs and large industrial loads) which may be a feature of entry/exit point connection agreements, we do not think that within day constraints are appropriate in the target model. However, we accept they may be required as interim steps in some networks and could help TSOs gain confidence in their ability to undertake a residual balancing role. Within day restrictions need to be pre-defined in the European network code in order to prevent a proliferation of different methods being adopted by NRAs, which would be counterproductive. Also they need not just take the form of restrictions on how gas flows at entry/exit points during the day, but could also take the form of restrictions in nominations (e.g. by requiring renominations up/down at one entry exit/point to be matched by an equal and opposite renomination at the virtual point or another entry/exit point, thus ensuring a user's portfolio remains balanced throughout the day). Where within day restrictions are applied as interim steps they should be applied equally to all network users.

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

We assume that this question refers to balancing against a pre-determined end of day offtake (i.e. the TSO will manage variances in the offtake over the day to reflect changes in weather) and not balancing to a pre-determined intra day profile (which undermines the end of day balancing principle). This being the case it would be a useful interim step in some markets (e.g. Italy) where it will take time to develop dynamic standard load profiles for non-daily metered customers and efficient allocation of non daily metered offtake. Such arrangements have also already been successfully applied in the German market. The difference between the pre-determined offtake profile, which users balance to and are cashed out against, and the actual offtake (determined at a later date via meter reads) should be managed through an efficient and non discriminatory reconciliation process, or socialised in distribution tariffs.

*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?*

We are not convinced that allowing or requiring TSOs to sell linepack is a necessary or efficient feature of the target model. We believe it may be difficult to design a meaningful linepack product which parties can value and it may also limit the extent

to which flexibility is transferrable from one market area to another. Nor do we favour TSOs selling flexibility products based on the linepack available within their system as these inevitably will be designed to appeal to certain types of user thus disproportionately restricting the amount available to others.

Selling linepack ex ante could also lead to problems of hoarding and the undiversified aggregate demand of users could exceed the theoretical supply and aggregate diversified quantity actually used by users, thereby creating false scarcity.

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

We do not believe free tolerances should be part of the target model as this weakens the incentives on users to balance and makes balancing procedures more complex. It may also increase the amount of TSO residual balancing actions, albeit probably not materially. However, we believe free tolerances are an important interim step which will help build user confidence and mitigate imbalance risk on the way to the target model.

#### **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?*

Notwithstanding ERGEG's current consultation on transparency requirements for gas (E10-GWG-68-03) we believe the information requirements specified in Article 21.2 and Chapter 3 of Annex 1 of the Regulation are sufficient to ensure TSOs can implement the target model and the interim steps both safely and efficiently. That said, we would expect the European network code to be more specific about how such information, which is necessary for users to balance their portfolio and to understand the balance status of the system, will be provided and how frequently (particularly non-daily metered demand).

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

Obviously in order for the principle of TSO residual balancing to be efficient it is vital for users to have accurate information about their imbalance position throughout the day so that they can take steps to mitigate their commercial exposure to imbalance charges. The framework guidelines should state this principle and the TSO is clearly instrumental in providing such accurate information. We believe that careful consideration should be given in the European network code as to what information about a user's within day entry/exit flows is provided by the TSO (in some cases based on information provided to the TSO by the DSO) and what information users should secure themselves. In our opinion it is too simplistic to say that TSOs will provide users with regular updates of their imbalance positions within day, and mandating this may delay implementation of the full target model in some Member States.

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

The first question is too general and can only really be answered by TSOs. As previously stated users will clearly need access to accurate information about their imbalance position within day, but how such information is secured and who is responsible for providing it should be laid out in the European network code (and may conceivably differ between Member States).

### **Balancing periods**

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

The policy options are well considered and thorough, reflecting the three most common balancing periods currently in operation within the EU.

With regard to hourly balancing periods the policy options conclude that where a liquid intraday market exist this may be an efficient provision. However, we do not believe it is possible for liquid intraday markets to exist in hourly balancing regimes, or daily regimes with tight within day restrictions (as demonstrated in Belgium and Holland), and so do not believe hourly balancing is a credible policy option.

We believe that adopting an end of day balancing period across the EU is the policy option most likely to facilitate gas trade and support the development of competition within the EU. Theoretically this is possible, as the amount of flexibility available within each Member State will not vary in an end of day balancing period compared to an hourly or cumulative balancing period. However we recognise the risks and challenges posed with adopting end of day balancing periods in restricted networks, or those with high transit flows.

At this point in time neither TSOs, Regulators, users or the Commission know for sure whether implementing a harmonised end of day balancing period will be an efficient and safe solution for all Member States, or whether it will deliver the benefits that are expected. However we believe it is right to try and implement this target model and any assessment of efficiency and benefits arising from such an approach should be considered at an EU level rather than specifically on a Member State basis.

Experience from GB shows that it takes time for TSOs and users to adapt to a pure residual end of day balancing regime and that a number of different interim measures are needed to build confidence. Nevertheless such a regime incorporating TSO residual balancing, strong commercial incentives on users to balance and flexibility for users to adjust their positions, both physically and at the virtual point, has proved to increase liquidity, competition and innovation.

A cumulative balancing system like the one shortly to be introduced in the Netherlands has some merits (for example in more accurately targeting balancing costs) and is an improvement on hourly balancing/settlement used in some restricted networks. When operating in restricted networks cumulative balancing periods have been claimed to reduce the extent of TSO residual balancing action compared to a daily balancing regime, which may be the case. However as yet we have no experience of how frequently TSOs will take balancing action under a cumulative system



and it is not inconceivable that this could still occur several times within the day on a relatively large number of days. If TSO balancing actions do occur regularly within day it is hard to see how a cumulative balancing period is significantly more beneficial than a daily balancing period. We also believe a cumulative balancing system is more complicated to implement and operate than a pure daily balancing system and is more IT intensive as regards imbalance calculation, allocation and settlement. It also limits the scope for virtual trading within day and complicates how defaults are recompensed in supply and trading contracts.

To this extent, whilst we see a cumulative balancing period as a legitimate interim step towards the target model we do not at this stage believe it is an appropriate model for implementation across EU networks.

*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?*

ERGEG have duly considered the main policy options on balancing periods and rightly concluded that an end of day balancing represents the most appropriate basis for harmonising balancing periods across the EU.

*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.*

We believe harmonised balancing periods (and gas days) will better facilitate the movement and trading of gas between market areas, and create conditions (and/or remove obstacles) for greater integration of balancing zones and market areas. They may also encourage regional System Operators to be established and create impetus for national TSOs to put greater focus on regional planning. In our opinion end of day balancing is the most appropriate period for harmonisation across the EU and is most likely to secure such benefits

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

In our opinion end of day balancing is the most appropriate period for harmonisation across the EU and is most likely to secure the benefits described above. As such it is right for the target model to include such an aspiration, albeit this will be challenging in some Member States, and to incorporate interim steps which TSOs can implement as stepping stones towards achieving it.

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

We agree with the target model as we believe this is likely to facilitate gas trade and support the development of competition within the EU. Achieving the target model will be difficult in some Member States and ultimately may prove not to be achievable in all of them. In our opinion however, it is a legitimate aspiration at this stage and one all stakeholders should pursue with vigour.

*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 a major energy trading company operating extensively throughout Europe and beyond we will obviously need to expend valuable IT and manpower resources adapting our trading, gas operations and settlement systems to meet the requirements of the target model in those markets where we operate. At this stage we have not sought to quantify our costs but we fully expect the benefits arising from greater competition, liquidity and opportunities to trade in EU markets to more than outweigh them.

Also having a single harmonised balancing regime across the EU is likely to mean we are able to manage more of our trading, operations and settlement activity on a single IT platform, thus concentrating our IT development. It should also allow us to enter new markets more rapidly and may also encourage competition in gas market operations software provided by third parties.

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

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

Once again the policy options are well considered and thorough.

*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?*

We agree with the target model of TSOs buying and selling gas on the wholesale market to balance their system. This will provide the TSO with access to the largest number of buyers and sellers and the deepest pool of liquidity, so should minimise its residual balancing costs.

Standalone balancing platforms on which only the TSO can buy or sell gas may be accessible only to certain users (e.g. those with physical gas or physical gas which can be delivered within certain lead times) and would sterilise flexibility which could otherwise be offered in the wholesale market.

Under the proposals included in the 3<sup>rd</sup> package wholesale trading is expected to migrate to virtual points and we expect that in due course TSOs will gain confidence in being able to residually balance their system by buying and selling gas at a virtual point, thus creating price signals which commercially incentivise users to adjust their imbalances accordingly. However, TSOs are always likely to have recourse to buy and sell physical gas in order to balance their systems, and in some cases physical gas at a specific location.

We think that target model needs to be more specific about the wholesale market mechanism TSOs should use. We suggest that this be defined as an independently operated cleared electronic gas exchange which facilitates the TSO and users procuring day ahead and within day gas anonymously between themselves, both at the virtual point and physically (at an unspecified or pre-defined location). As an interim step it may be necessary for TSOs to buy/sell physical gas over a specified number of hours within a day (particularly in restricted networks) and so this option may need to be incorporated in the independently operated gas market exchange where appropriate.

We also think the European network code needs to be quite specific about what balancing services should always be purchased on the wholesale gas exchange, or balancing platform, and what may be more efficiently managed by way of competitively tendered short term bilateral contracts, or OBAs. In principle locational flexibility should be procured through the gas exchange or balancing platform and so this should be provided for within such mechanisms, and in the target model. However, as an interim step it may be necessary for TSOS to contract for this separately should the number of sellers be limited.

Intra system/market area location specific imbalance charges should not be countenanced in either the target model or as an interim step as these will discriminate against certain users and undermine the development of liquid hubs.

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

Independently operated gas exchanges have already been set up in some market areas and are at a nascent stage of development in others. The TSO clearly has an important role to play in implementing the target model. However, we would expect the bulk of the cost of setting up cleared electronic gas market exchanges will be met by third party providers.

From a users perspective it will be important to ensure that the wholesale markets in which TSOs and users buy and sell gas is run as efficiently as possible (to minimise transaction costs) and is developed in line with wider changes being proposed across the EU on financial market regulation.

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

The interim steps described in the framework guidelines represent appropriate measures that may be required as stepping stones towards implementing the target model in a number of countries we operate in. Where sources of flexible gas are heavily concentrated and TSOs already have long term contracts in place for balancing services we agree that TSOs should release any surplus back to the market.

*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?*

As stated in our response to Question 24 we think that gas exchanges which facilitate TSO residual balancing and user to user trading should be included in the target model. In any balancing regime it is important for users to be fully aware within the balancing period of what actions TSOs have taken, what cashout prices result from such actions and the extent to which cash out prices will change if further residual balancing actions are required. It is also important for users to know that any residual balancing trades made by the TSO are fully secured, and that they will not be exposed to balancing neutrality costs caused by the failure of other users.

We are concerned that if TSOs are allowed to buy gas on the OTC market or using pre-existing gas exchanges (which have not been designed to reflect the TSOs residual balancing needs) this may not achieve the necessary transparency and reassurance required of the balancing market. It also may not provide for the full range of

virtual, physical, location and temporal products the TSO may require access to. However, the existence of OTC broker platforms or pre-existing gas exchanges should help to ensure gas exchanges which are fit for residual balancing purposes can be put in place quickly.

*Question 28: Is it appropriate for TSOs to procure balancing services on the wholesale market and/or or is it 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?*

It is appropriate for TSOs to procure balancing services on the wholesale market via an independently operated cleared electronic gas exchange. Standalone balancing platforms are an appropriate interim step and could in some cases be taken over and operated as exchanges. However, until such time as liquid within day wholesale markets develop it may be appropriate for TSOs to provide some of their residual balancing services through bilateral flexible gas contracts. It is important for any such contracts to be competitively tendered when flexibility is available from a number of different sources/suppliers and be short term in duration. Whilst such contracts may be appropriate in circumstances where there is little liquidity, it is important to recognise that the more TSOs rely on such contracts in order to provide residual balancing services the less likely it is liquidity will grow and the more flexibility/capacity will be held back from being offered to the market..

*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?*

We believe it is possible in due course to reduce TSOs reliance on long-term contracts for balancing services in all of the markets we operate in. In a number of markets it will take time for TSOs to gain confidence in their ability to residually balance their systems by purchasing gas on the wholesale gas market but we believe this can be best achieved by giving TSOs incremental targets (as in France) and financial incentives to acquire certain proportions of gas from the market.

## **Imbalance Charges**

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

Yes

*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.*

We agree that the methods for calculating imbalance charges should be harmonised. When transporting gas across Europe it is important for network users to understand how any imbalance occurring in a particular Member State will be treated and applying consistent methods will make this easier. Also different balancing rules may lead to inefficient arbitrage as users seek to avoid an imbalance in one market area (where imbalance arrangements and rules are more penal) by creating an imbalance in another market area (where the balancing regime is less disadvantageous).

*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;*
- *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.*

We support the target model which envisages cashing out user imbalances each day (regardless of whether there has been any TSO balancing action) and which bases imbalance prices on the marginal price of gas bought and sold by the TSO during the day. This places the strongest incentives on users to balance and deliver/accept gas they commit to sell/buy compared to an average cashout price, which lessens these incentives.

In the event the TSO is not required to take buy and/or sell action on a day, dual cash out prices (for long and short positions) should be applied in order to continue incentivising shippers to balance. However, they could be based on an average of the trades on the wholesale gas exchange plus a pre-defined % factor, which is added to and subtracted from the average cost and which ideally should be harmonised across the EU.

Whilst there may be merit, as an interim step, in employing imbalance rewards and penalties based on whether a user's imbalance is helping to reduce or adding to the overall imbalance of the system, we do not think they should be part of the target model. This is because we think they could conflict with, or confuse, the commercial incentives created by marginal imbalance prices within an end of day balancing regime. We think residual balancing will be more efficient if shippers are actively incentivised to balance their position through the application of dual marginal cash out prices rather than passively rewarding them, or penalising them, for having an imbalance position contrary to that of the system as a whole. Also any intra day penalties (as opposed to incentives) applied to imbalances, whether they be actively or passively applied, will undermine an end of day gas balancing system.

We also think that careful consideration should be given in the European network code about the extent to which TSOs purchases of locational balancing gas should feed into cash out prices, as such purchases are often made to relieve locational constraints rather than imbalances in the system as a whole.

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

We do not expect there to be any significant costs of implementing marginal cash out prices across the EU. Such costs will be included within the overall costs of establishing independently operated cleared electronic gas exchanges.

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

Basing imbalance charges on a proxy of prices in more liquid neighbouring markets is an appropriate interim step and one which has proved successful in helping to establish market based balancing arrangements in France and Germany.

### **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 policy options appear to be comprehensive.

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

The policy options described represent different ways of encouraging cross border cooperation and integration of balancing zones/market areas with varying degrees of intervention.

At this stage it is far from clear what the efficient physical (as opposed to political) boundaries of balancing zones will be, so we think it is premature and counter productive to consider options for enforcing the merger of zones at this stage. In our opinion merger of balancing zones should be considered from a bottom up perspective and as a first step regulatory efforts should be concentrated on ensuring as much harmonisation as possible in balancing arrangements (and other arrangements such as capacity allocation, congestion management and tariff setting) across Member States. Such an approach will, in our opinion, reveal where the market pressures for integration lie and what the true limit of the efficient physical balancing zone boundaries are. In seeking to implement harmonised balancing (and other operational) arrangements TSOs may also discover that this can be achieved more easily using a joint approach with neighbouring TSOs, which could lead to integration and regional system operation being achieved organically. To this extent we support the framework guidelines requiring TSOs to review, assess and consult on how cross border cooperation and balancing zones can be achieved but we are wary of any obligations which might be seen to mandate mergers at this stage.

Cross border netting and pooling are useful interim steps towards merger of balancing zones. However, we question whether these should be applied universally, as allowing for netting/pooling in situations where there is no agreed intent between TSOs to operate their respective balancing zones as one could be counterproductive, as this could reduce cross border trade and sterilise cross border transmission capacity for TSO use.

*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?*

OBAs are useful for dealing with small differences that may arise between the nominations and actual flows across market areas and with gas quality differences. To the extent they do not already exist we agree they should be put in place.

OBAs are rarely visible to users and as such there are concerns that their scope may extend beyond providing for steering and quality differences to include provisions relating to balancing services or constraint management. As such we think there should be greater visibility of OBAs and that the European network code should specify what they should (and perhaps more importantly what they should not) include.

**Other**

*Question38: ERGEG would welcome comments on whether the scope of the target model and the level of detail in the draft pilot framework guideline are appropriate. For example, the draft does not currently address nomination procedures which the network code will have to cover according to the Regulation 715/2009.*

We have no further comments to add.