

**Union of the Electricity Industry – EURELECTRIC
Comments on the
EREG Discussion Paper
“Gas Balancing”**

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These comments were drafted by the following members of the SG Gas:

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Union of the Electricity Industry–EURELECTRIC is the European association representing electricity companies and as such also large gas users. We welcome the opportunity to comment on the discussion paper on “Gas Balancing” as part of the public consultation process initiated by ERGEG. We also acknowledge the extensive work already done by ERGEG but also ask for further reflections on the issue.

Overall we agree with the features of an efficient balancing regime as stated in Figure 4 of the discussion paper. However, we have reservations concerning some of the principles and statements set out in the discussion paper, in particular regarding the provision of available linepack to shippers, as will be explained below.

Question (1): Are there other features that should be reflected in a gas balancing regime to help ensure efficiency and to maintain safety and security of the system?

We agree that TSOs should use market-based procedures for buying / selling gas in order to maintain the physical gas balance of the system. We also accept that there may be occasions where purchasing ancillary and similar services from shippers (e.g. interruption, flexible offtake, etc.) could support the efficient operation and balance of the system and that such transactions should usually be carried out following market-based procedures to promote transparency and efficiency.

Regarding the disaggregation and sale of system linepack (see in more detail the answer to question 5), we have doubts that this will lead to efficient outcomes. It would be better in our view if TSOs could continue to manage system imbalance using linepack in a bundled way.

Question (2): Should the incentives to balance become stronger the further away a shipper is from being in balance or are there are other ways of ensuring that shippers have appropriate incentives to minimise their imbalance positions? Should shippers be allowed to trade their imbalance positions on an ex-post basis as a way of improving overall efficiency?

The principle of penalising imbalances is based on the fact that system imbalances, in aggregate, imply costs for the system. Individual imbalances have the potential to increase costs for the overall system, but the actual costs are dependent on the overall behaviour. Imbalances are also an inevitable condition of shipping gas since inflows and offtakes are subject to uncertainties that cannot be wholly eliminated. As a consequence, small tolerance bands could be included in the services provided by a TSO. However, if the tolerance bands included in the services of a TSO are too wide, it could lead to discriminatory network charges, as a shipper would have to pay for a large tolerance even if the individual shipper only causes insignificant imbalances.

We accept the principle of targeting costs at those users which cause the imbalances with the greatest impact on the system. However, unduly complex mechanisms can create a barrier to market entry.

Any imbalance cash-out mechanism should both provide robust incentives to balance and target the costs incurred by the TSO, in its role as residual balancer of the system, at those that are out of balance. We agree that there may be merits in exploring approaches to gas balancing that have stronger incentives the further away a shipper is from balance. However, such models would need to be assessed in the appropriate context of each market and care has to be taken that this neither introduces undue complexity in the balancing system nor has a detrimental impact on small players or new entrants. Therefore, it might be preferable in the short- and mid-term to use a single imbalance charge with some tolerance levels.

Imbalance price transparency is also an important factor and prices should be available on a real time basis. More complex, escalating imbalance prices could diminish this price transparency and as shippers would not be in a position to know which imbalance price band they might be in at any point in time, the incentives to balance provided by such an approach may not be an improvement over more simple cash-out arrangements.

We believe it is important that shippers be allowed to trade ex-post their imbalances, in particular in still immature markets.

Question (3): Does hourly balancing create any barriers to the development of competition?

Short balancing periods, i.e. purely hourly balancing, can create significant barriers to the development of competition, in particular by disadvantaging and discriminating against new entrants or small players.

It is quite unlikely that the information flow can be updated quickly enough to provide the necessary information for shippers to correct their hourly imbalance or that shippers have enough time to intervene to correct their imbalances in time. As a consequence, under purely hourly balancing regimes, shippers have to cope with the additional burden caused by uncertainties in their balancing position, which may cause additional costs in term of imbalance penalties, thus causing small operators and new entrants (who are more exposed to imbalances) to leave the market.

In addition, hourly balancing is not consistent with the TSO's residual role and does not allow the TSO to make best use of the inherent flexibility available in the system, i.e. linepack, which is essentially a physical system balancing tool for the TSO.

Question (4): What information is required to ensure that gas balancing regimes operate effectively and efficiently and how often should this be provided? What is the best way of ensuring that this information is provided to all parties on a non-discriminatory basis?

Shippers will require information on their own balance position within the balancing period and the balance position of the system overall. This should include *inter alia* information on the flexibility instruments available on the system to manage imbalances, actual and forecast entry and exit flows, system demand, line-pack status, key pressures at critical points, etc.

Data should also be published as close to real-time as possible to all parties on a non-discriminatory basis to enable shippers to react to the physical status of the system more quickly, balance their position and enhance overall market efficiency. This time frame must be such as to allow shippers, within the imbalance time-frame, to take the necessary action to avoid imbalances. There is a need to ensure, as far as is reasonably practical, symmetry of information across all stakeholders.

Question (5): Should linepack (where technically feasible) be made available to shippers on a non-discriminatory basis to improve access to flexibility? Are there any other steps that could be taken to improve access to flexibility that would not impinge on the safety and security of the system?

Although in principle the increase of the number of flexibility instruments could help to reduce the cost of individual shippers in managing their imbalance position, it is not evident that the availability of linepack, not needed for system security, directly to the shippers would be a simple and efficient means to reduce system costs. We also do not consider that an efficient balancing regime needs to include market-based procedures for making linepack available to shippers, such as ‘linepack inventory accounts’ in order to make efficient use of available physical flexibility in the system.

In our view, flexibility is inherent in the system and the provision of flexibility should remain part of a bundled access right. Linepack flexibility should remain a tool for the TSO to physically balance the system and we believe it is the TSO, rather than individual shippers, that is best placed to manage the efficient use of the overall system linepack. The application of linepack inventory accounts would add complexity and it is not evident that the benefits would outweigh the costs of implementation.

See also our comments to Principle 8.

Question (6): Do differences between (neighbouring) gas balancing regimes distort or the incentives provided to market participants? If so, what degree of consistency would be appropriate to overcome these problems? Would there be any disadvantages from introducing more consistency in features of (neighbouring) gas balancing regimes? How could this consistency be facilitated – for example would legislation be required or could it be achieved through better co-operation between regulators and TSOs in different Member States?

Differences in neighbouring balancing regimes may distort incentives to market participants, particularly where balancing periods and cash-out prices vary significantly. In an extreme case, gas could move across borders simply to manage cash-out exposure rather than to meet customers’ demand or in response to genuine price signals. This also applies for the transit of gas through networks which have different balancing regimes. Moreover, there is the risk that flexible regimes are put under stress to compensate for the lack of flexibility in the balancing regime of a neighbouring country. Even small differences in the balancing system procedures, due to technical differences of the neighbouring transmission system, imply additional costs to the shippers, who have to gather the necessary information to operate under different regimes and to manage the differences during the normal operation. This may cause additional barriers to entry into a market.

The existence of differing balancing regimes has significantly hampered gas trade in the past and we therefore think that greater efforts need to be made to achieve sufficient harmonisation of the gas balancing schemes between Member States. A voluntary approach based on co-operation between regulators, TSOs and all other system users, would be the preferred approach to reach a harmonised balancing regime. As an initial step, regulators should conduct a detailed survey on balancing regime interactions.

Question (7): Would cross-border (or international) balancing zones help facilitate the development of competition in gas across Europe? What technical, legal and practical issues would need to be overcome if cross-border balancing zones were introduced? What impact could cross-border balancing zones have on the development of hub based trading and regional markets (see for example the recent ERGEG document on regional markets in electricity)?

Cross-border balancing zones are likely to be a necessary stage in the transition to a more integrated European gas market and we would support their development. Because gas resources are not evenly distributed, there is much greater cross-border trade in gas than in electricity.

We recognise that the regional market concept has some merit in relation to electricity, but believe that exactly the same principles cannot necessarily be applied to gas. It should also be noted that regional markets can potentially pose problems for the integration of the wider European market unless there is a concerted attempt to ensure that developments move in the same direction. Progress on a regional basis must therefore be accompanied by a convergence of regulatory approaches.

The harmonisation of different balancing regimes should also have the goal of maintaining the flexibility of the most advanced balancing regimes.

Question (8): Would it be appropriate to increase the level of consistency between balancing rules for transit and transportation systems?

The preferential access rights for transit contracts represent a major obstacle to the development of gas-to-gas competition in Europe. We would support efforts to achieve greater consistency between the balancing regimes for transit and transportation systems and in particular to ensure that the transit regime does not benefit from more favourable balancing arrangements. Greater transparency regarding balancing arrangements would also be desirable.

Question (9): Would the introduction of Operational Balancing Agreements (OBAs) between transit and transportation systems improve transparency on how the balancing regimes interact? If so, what should be included in the OBAs?

As stated in the answer to question 8, it is important that the same regime applies to both transportation and transit systems. If this is the case, OBAs are not necessary.

However, while the transit and transportation systems remain inconsistent, operational balancing arrangements are a pragmatic means of dealing with physical imbalances between TSOs while allowing shippers' nominations at system interfaces to be kept whole. Such arrangements ease the commercial transfer of gas between markets, thereby facilitating competition. We also agree that transparency in the interaction between transit and transportation systems would be likely to be beneficial to new entrants.

Comments on suggested changes to the existing CEER gas balancing principles

Principle 1 – Balancing responsibilities

We support this change which clarifies the responsibilities of the participants in balancing markets.

Principle 2 – General requirements for balancing rules

We support this change and welcome guidance highlighting the importance of supporting decisions to change gas balancing rules with objective criteria and analysis. In this context we also welcome the intended public consultation with all market participants regarding changes to the balancing rules.

We recognise the importance of minimising the residual role of the TSO within any balancing rules and the acknowledgement of the need to facilitate effective competition, avoiding undue barriers to new entrants.

Principle 3 – Frequency of balance

We think that access to line-pack for the shippers would add complexity and could increase the cost (see our answer to Question 5 and our statement to Principle 8). Any move to introduce a linepack service would more than likely also create inconsistencies with the penultimate bullet point of the costs imposed by any such regime.

The proposal correctly adds the need that the balancing design should take into consideration the interactions between connected systems to ensure that no undue barriers to cross border trade are erected. As most of the EU Member States are strongly dependent on gas imports, it is very important that all systems used to transit gas have the same or compatible balancing period.

We welcome the addition stating the importance of shippers not being exposed to undue risks that they cannot manage effectively. We agree that such exposure, such as a penal cash-out price, could create a potential barrier to entry to the market.

Otherwise, we broadly support the proposed changes, in particular the requirement that balancing periods should be compatible with the availability of imbalances information in order to take balancing actions.

Principle 4a – Balancing Costs

We support this change, in particular to point out the need to rely where possible on market mechanisms.

Principle 4b – Charges for imbalances

We support the changes, in particular the clarification that imbalance charges should not result in a distortion of competition, must be cost reflective and the method for calculating them must be made public.

Principle 4c – Trading of imbalance positions

We support this change, agree that ex-post trading of imbalance positions could help shippers avoid imbalance penalties and that this is most relevant to markets where there is limited within-day trading.

Principle 5 – Tolerance services

Tolerance levels are important and we generally support the changes in connection with how to set this tolerance.

Tolerance services are in particular a useful tool in less mature or less liquid markets and are a pragmatic means of addressing some of the uncertainties surrounding balancing. Although the possibility of adopting different market mechanisms would in principle increase flexibility and reduce costs, we agree that secondary trading of tolerances should be permitted. However, we are unclear as to how this could interact with the trading of imbalance positions (Principle 4c) and are concerned that this could introduce unwarranted complexity into immature markets that could inhibit the development of trading in the commodity itself, gas.

Principle 6 – Information and transparency

Overall we support the changes made.

The amendments underline the crucial link between the provision of information and correct management of imbalances. Network users need clear and timely information on their imbalance status in order to correct their imbalance position in time. Otherwise they are forced to adopt precautionary behaviour, taking decisions under strong uncertainty. Balancing periods should thus be consistent with the time frame of the information flow regarding imbalance position.

We also consider that the principle should be extended to require TSOs to provide timely information on the status of the system in aggregate and not only individual shipper positions. Such information could include gas entering / leaving the system, linepack actual and projected, flows through compressors and pressure at key points in the system, actual and forecast. More transparency of information should be encouraged and would improve confidence in the market and market efficiency, provided such disclosure does not unduly disadvantage market participants through the exposure of individual company positions.

We agree that delays in the allocation process will negatively affect shippers. However, the proposal of using provisional allocations to calculate imbalance charges does not seem satisfactory if changes to the charges -once fixed- can negatively affect the shippers.

Principle 7 – Harmonisation of balancing rules

We support the changes made.

Principle 8 – Provision of flexibility

We do not support the introduction of this principle at this time, as it goes beyond the requirements of Article 19 of the Gas Directive and would pre-empt ERGEG's plans to introduce guidelines for third party access to linepack in line with this Article 19. The Directive's Recital 22 and Article 19 seem to suggest that linepack could be made available or should be made available when technically and/or economically necessary for providing efficient access to the system, whereas the proposed principle suggests that TSOs should maximise the availability of linepack not needed for system security to help ensure the efficient use of available flexibility in the system.

Whilst we agree in principle that the provision of flexibility to shippers might assist certain shippers in possession of flexibility rights to manage their imbalance position and potentially reduce overall system costs, it is not self evident that this would be the outcome. Such fundamental changes, which would have a significant effect on any gas market, should be scrutinised through a separate consultation process in its own right and be subject to a full impact assessment, to enable stakeholders to fully understand and evaluate the associated costs and benefits.

Stakeholders cannot be expected to form views on high-level principles without being presented with all the facts and figures.

The principle does not seem to contemplate that the disaggregation of system linepack could lead to less efficient utilisation of system flexibility as a result of increased operational costs through increased complexity and potentially more residual balancing actions by the TSO with higher costs that may not be appropriately allocated. We consider that it might be more efficient overall for the TSO to be properly incentivised to utilise system linepack in aggregate on behalf of all system users so as to minimise overall residual balancing costs, and that this option should not be removed by the introduction of this principle.