

GSE Response to CEER consultation

“CEER Vision on the Regulatory Arrangements for the Gas Storage Market”¹

1 Who is GSE

Gas Storage Europe (GSE) represents the interests of 32 Storage System Operators with around 110 storage sites in 16 countries in Europe, representing approximately 84 bcm, i.e. 87% of EU technical storage capacity. GSE is one column of Gas Infrastructure Europe (GIE), the European association of the Transmission, Storage and LNG terminal Operators.

GSE is committed to improving the regulatory and investment framework for storage activities in order to help its members to continue providing secure, efficient and valuable storage services to the market.

2 Response to CEER consultation

1. Do market participants value all three values of storage identified by CEER (arbitrage, system and insurance) in the market price? [Section 2.1]

No, users/shippers are mainly focused on the intrinsic value of storage facilities.

More precisely, seasonal spread has been the fundamental driver of storage value from the shippers' point of view. In recent years the gas market fundamentals have undergone a significant shift in Europe altering the supply/demand balance. This has been triggered by several factors including the integration process, energy market globalization, macroeconomics and political choices. As a result, the seasonal spread has narrowed down considerably removing price signals for storage.

While seasonal spread may be a legitimate criterion to value storage, it should not be the only one. As much as it can offer a *forecast of average commodity prices* at a given point in time, it does not reflect the complete value of storage. In fact, seasonal spread:

- Cannot predict exceptional events: it is a virtual, not physical, estimate based on market sentiment about the availability of gas in a given period. It cannot thus predict exceptional events and their impact. A technical failure, a political fallout, an exceptionally cold weather etc., may significantly affect the supply/demand balance generating a risk of physical supply interruptions and/or price spikes.

This is crucial as Europe is increasingly import-dependent and exposed to global market dynamics. In fact, an exceptional event in one market will affect other markets. An unusually cold weather in Germany may push up prices in the Netherlands or in the UK. Similarly, diversion of LNG vessels towards higher-priced markets (e.g. Asia) may increase price pressure in Europe if it coincides with peak demand.

¹ CEER Vision on the Regulatory Arrangements for the Gas Storage Market – A CEER Public Consultation Paper, ref. C14-GWG-112-03, 22 October 2014.

- Can be a vicious circle: in some instances, the use of storage to ensure continuity of supply may paradoxically reduce its intrinsic value as expressed by the seasonal spread. Increased withdrawals at winter end may have a bullish effect on summer gas prices narrowing further the seasonal price differential.
- Ignores short-term value extraction: it tells little of the value that can be extracted from storage through shorter-term price spreads. This “extrinsic” value of storage is difficult to quantify as it depends on a range of factors such as short-term price variations and individual arbitrage strategies.
- Disregards system efficiency: it cannot capture the contribution of storage to reduced network costs. Storage is located close to demand areas and thus allows reducing the peak load that the network would need to be tailored to otherwise. This allows avoiding investments. According to Pöyry, without storage Europe’s transmission and import infrastructure would have to be sized upwards by 9% to 16%.
- Reflects only part of the market: it is based on futures contracts which account for only a small part of demand. The bulk of physical supply to Europe is based on long-term contracts.

2. If the value of storage is not reflected in the market price, please elaborate on your understanding of the reasons hindering this and potential solutions. [Section 2.1]

The existing regulatory framework has been focused and built on the assumption that storage capacity was in high demand and hence that available capacities would always be booked and used in the value chain.

The economic downturn combined with long-term gas import contracts with high take-or-pay clauses, have caused a European gas over-supply. Additionally, other sources of flexibility have come into play. Especially, hub-traded forward products such as summer-winter forwards are seen as a comparable flexibility tool. Thus, storage users take the very low price level of such purely commodity-based flexibility tools as a reference, even though they are purely virtual and speculative. These summer-winter spreads do hardly cover operational costs of physical storages or (re-)investment needs.

Underground gas storages are to be considered as the necessary backbone of Europe’s security of supply as gas is located physically close to the demand area. Such benefits are limited when the market sources of flexibility are via hubs and long-term contracts. Nevertheless, it has to be taken into account that not all Member States count with underground storage capacity, for which solidarity across the Union is essential.

However, in the current market context, the full value of storage as security of supply provider may not always be recognized. Market players might anticipate that the worst situation will never materialize while sourcing gas directly from the hubs. They rely on either governments taking over this risk through intervention in an EU-declared emergency situation or other market players booking storage for their proper portfolio.

The regulatory environment should be conducive to storage use and commercial innovation. In order to compete with other sources of flexibility, storage operators need to be able to offer products that respond to increasingly varied user needs. The regulatory framework should therefore enable storage operators to provide such services while respecting the principle of transparency and non-discrimination.

Moreover, the European regulatory framework should take into account the fact that storage does not operate in vacuum but depends on the adjacent transportation network. The regulatory framework should thus warrant that rules for transmission do not negatively impact on the value of storage and that they ensure equal treatment of storage users and other network users, in particular:

- Transmission fees at storage points should avoid cross-subsidies and should reflect the benefits that storage brings for final customers.
- Unrestricted access to/from storage facilities from/to transmission network should be guaranteed (by way of firm transmission capacity) so that storage users are treated on equal footing with other network users.
- Storage users should not be penalized in system emergency situations: clear and non-discriminatory rules should be ensured in the case a transmission operator needs to revert to storage in system stress situations.

3. Respondents to the previous CEER questionnaire (launched in 2013) identified that users are currently less likely to enter into long-term commitments than previously. In your view, is this temporary (e.g. price related) or structural (e.g. long-term commitments are no longer desired)? [Section 2.3]

Users are reluctant to get in long-term commitments. This reflects a change from established stakeholders with long-term market responsibility towards more short-termism. Also the current over-supply situation, combined with other various options to provide flexibility, trigger more short-term focus.

As a result, some storage operators might have to temporarily mothball some of their facilities or even close them to save operating costs or to reallocate capital to more profitable uses. These costly measures have irreversible consequences and could eventually harm the security of supply of the European Union in the future while gas storage will be much needed in view of the decrease of indigenous flexible production, the development of renewables, the pick-up of gas demand for power after ETS reform and the disappearance of the effects of recession.

4. Do you agree with CEER's observation that storage competes within a wider flexibility market (e.g. with LNG, interconnection and virtual products)? [Section 3]

Yes.

However, it should be noted that all these flexibility tools differ in terms of price, the nature of the service, availability and proximity to demand. Some of them are not asset-backed and thus not able to support the system in case of shortage (including emergency situations). An increased use of such tools in shippers' portfolio and strategies leads to a higher risk for the whole system.

The majority of EU countries rely on storage as the main flexibility tool that can be *physically* guaranteed allowing a shipper to hedge the supply and price risk. In other words, storage provides an insurance against unexpected events. Such events may be of different nature but are often triggered by weather conditions, for instance cold snaps or prolonged periods of below-normal temperatures, as those witnessed in Europe in 2012.

5. In your view, are there further barriers to competition that have not been considered by CEER in this public consultation document? [Section 3]

GSE welcomes the CEER's view that the regulatory framework should not restrict SSOs to offer creative products and should facilitate commercial innovation.

Indeed, the lack of harmonization of the constraints that weight on some of the flexibility tools hinders the competitiveness of storage products.

6. Do you agree with the CEER recommendations for delivering security of supply through market mechanisms? [Section 4]

Positive developments in the market functioning have strengthened security of supply. However, security of supply cannot always be delivered through market mechanisms as it has been recognized by ACER in its vision for a European Gas Target Model.

Security of supply is best ensured by having storages fully booked and filled ahead of the winter.

Therefore, the primary aim of an appropriate future regulatory framework for gas storage should be to ensure the best possible use of the existing storage capacity. In doing so, the resilience of the European gas market is increased and an emergency situation might be prevented or if we end up in an emergency situation its impact would be less severe.

In this respect, we would like to note that the high filling levels ahead of this winter 2014-2015 due to a mild winter do not reflect the overall trend towards decreasing filling levels from year to year.

7. Where interventions are necessary, do you agree that the characteristics of interventions identified by CEER (e.g. transparency, clear roles and responsibilities, exit strategy) can help to minimise any potential adverse impact on the market? [Section 4]

We agree with CEER's view that in certain cases interventions may be required to correct proven market failure and that where interventions are introduced, the impact on the market should be understood and minimized.