

GIE response to the invitation for written comments on the “Quo Vadis EU gas market regulatory framework – Study on a gas Market Design for Europe” preliminary report presented on 26th June 2017

Introduction

GIE presents its initial remarks and comments to the preliminary report on “Quo Vadis EU gas market regulatory framework – Study on a Gas Market Design for Europe”.

GIE appreciates the efforts of the European Commissions in involving all stakeholders in this phase of the Quo Vadis study and GIE is committed to contribute to the process based on its knowledge of the TSO, SSO and LSO market in Europe.

We would like to stress that there has been limited time for reflecting on the initial report. It may prove more value to facilitate a process with stakeholders that would allow for further reflection and dialogue taking the importance of the topic into account. GIE does not see a need for coming to rapid and potentially incomplete conclusions, taking into consideration that any changes in the gas market design are not to be proposed within the term of this Commission.

GIE will, however, once again like to express our availability and commitment to continue the dialogue with the European Commission on ensuring a gas market that provides welfare to the EU citizens.

Market development

GIE shares the view of ACER that the European gas market is developing in a positive direction where the network codes have in fact been implemented.

With this in mind, GIE would suggest that the Commission more clearly expresses which kind of problems a revised market design should solve.

It should be noted that the European energy system is changing in relation to the energy transition and it would be inadvisable to make significant changes in market design that does not take these developments into account.

GIE would especially like to draw the attention to the fact that a potential new market design should ideally:

- Help to achieve a well interconnected, integrated and flexible gas infrastructure network in Europe as a way to enhance supply security, integrate European wholesale markets and ensure the free flow of energy across the borders
- Reduce uncertainty in relation to an energy market under transition to reach the targets of the Paris agreement
- Facilitate the increased decentralized production of renewable gasses through cross border trade

- Ensure that new and existing customer segments have easy access to the gas market
- Facilitate that gas remains competitive on the electricity balancing market where an increased number of technologies are competing, but where the gas system remains the most potent player for providing large capacities
- Minimize the barriers to investments and innovative uses of gasses across sectors, i.e. power to gas
- Take into account that gas flows are becoming more and more variable, along demand changes. Therefore gas infrastructure operators will have to deal with a more variable utilization of some infrastructure assets which may challenge capacity charges
- Incentivize market players to make high fill levels available in the storage facilities to ensure high withdrawal rates are available for flexibility and security of supply purposes
- Ensure that there is no discrimination between flexibility providers among all gas infrastructure assets

Market integration

GIE acknowledges that market merges can provide additional EU welfare. The current market rules already allow for this as observed in different parts of Europe where markets are merging to various degrees. However, local conditions in infrastructure, market activity and regulatory framework will have to be analyzed thoroughly to determine the value of market mergers. In addition the relevant member states need to be actively supporting this.

On this basis, it is the view of GIE that market mergers are best handled through a bottom-up approach in order to assure that the market areas in question are mature enough to merge. In this process it should also be ensured to avoid creating supersized market areas that are technically sub optimized and may make it difficult to provide market signals for new infrastructure inside a large market area.

It may be considered to develop a transparent set of indicators that could provide the basis for further analysis of the potential for individual market mergers. Such an approach could help bringing fragmented national markets into regional hubs.

GIE encourages the Commission to collect experiences and learn different approaches from those member states, which have already been or are currently working towards merger of markets.

Storage challenges

From a storage company perspective it appears that the situation of non-regulated TPA gas storage market is lacking. Storage System Operators (SSOs) find themselves in a situation which requires them to compete with price signals that are below the costs they incur to operate and maintain their facilities.

If the current situation persists, it would put at risk at parts of the storage industry and harm the security of gas supply in Europe. Therefore, there is an urgent need to address the necessity of high fill levels in storage sites to ensure the maximum withdrawal rates to cover shortages. Setting a methodology for valuing secure energy supply in the new gas market design could serve as an important part of preparing a coordinated regional approach to secure gas supplies in stress

situations¹.

Moreover, storages will in the future gas market design play an important role as competent partner to renewables and as back-up system for the switch to renewables. This additional value storages are generating should also be part of the analysis. Currently a scenario paying attention to the future gas market design with regard to renewable energies is missing.

Relevant topics for Gas Infrastructure Operators that are missing in the study

I. Need to further integrate infrastructure sectors in a sustainable Energy System

Gas and electricity markets do already closely interact with each other. Given the accelerating uptake of electricity from renewable sources and the increasing need for backup electricity generation from gas, an ever closer cooperation between the two systems is expected in the future. There is thus value in increased horizontal integration across energy markets. While massive investments are planned and realized in electricity infrastructure, the EU natural gas system, which is already well connected in most parts of Europe, requires fewer investments and should thus be utilized to the benefit of the EU consumers.

Practical examples to be considered in the regulatory scenarios:

Linking electricity and gas markets has practical implications for policy makers; network development decisions should be taken in a holistic manner and not focus on a higher level of electrification. System adequacy assessments should therefore take into consideration the conversion of renewable electricity into renewable gas (e.g. hydrogen or synthetic methane), which would allow efficient storage and transport of renewable electricity in a gaseous form. This role has to be recognized in a new gas market design, to focus more on overall system performance and exploiting synergies between sectors.

II. How Gas Infrastructure can enable an affordable energy transition

Gas can make significant contributions to the reduction of CO₂ at national levels whilst improving air quality. Gas and gas infrastructure (including storages and LNG terminals) provides the flexibility which is needed to integrate an increasing share of variable renewables into our energy system, whilst helping to guarantee a more secure and resilient electricity system for the EU consumers.

Europe's energy system transition is in progress and accelerating. The gas infrastructure operators are definitely well-placed to be an integrated part of this transition. Under the right regulatory framework infrastructure operators could be more innovative and contribute to the transition by offering new services and technologies to the market which taking advantage of the already existing gas infrastructure system.

Practical examples to be considered in the regulatory scenarios:

Examples where flexibility should be allowed for regulated infrastructure operators is cooperation with players on Power-to-Gas, bio-methane and gas for mobility. The already existing gas

¹ On page 12 the statement that "for daily balancing, import/export of flexibility is more expensive than that provided by local storage as cross-border entry/exit tariffs are higher than tariffs to and from gas storage and storage prices are also low" is not reflecting market realities. In addition the usage of the storage facility has one more tariff component: storage flexibility: gas price, transport tariff, storage tariff vis-a-versa production: gas price, transport tariff. For example, in Germany the full E/E tariff also applies for cross border use of storage capacities.

infrastructure, being well interconnected in most parts of Europe, could under the right regulatory framework play a significant role in transport and storage of renewable energy.

A new market design should help provide a robust and flexible regulation that provides sufficient support that the sector needs in order to nurture these technologies and ensure that new and innovative business models are brought to the market. Operators of gas infrastructure need legal flexibility and financial muscles to take on this innovative role and develop new products that would help in the transition towards a more sustainable energy system.

Comments on Regulatory Scenarios

In this paragraph, GIE would like to briefly comment on the scenarios presented in the report.

TSO Compensation Fund

The first 3 scenarios entail the establishment of a TSO Compensation Fund (TCF) as a remedy for providing the individual TSO with a neutral revenue compensation for its services in situations where there may be no intra-EU border tariffs. This appears to be a complex and not fully developed setup that may impose comprehensive redistribution of revenues between TSOs on an undefined basis. In particular the effects of (i) a potential harmonization of the economic regulation of TSOs at the EU level or (ii) a correction of the TCF mechanism to compensate welfare distribution amongst member states should be further detailed with regards to TSO revenue neutrality.

Although there are examples similar to the proposed TCF mechanisms across the EU, these are always implemented at national level. The implications and risks associated with the establishment of an EU-wide TCF should be fully assessed in the following phases of the study in order not to overestimate its feasibility.

Even in a national and stable market this would be difficult to deal with both politically and from a regulatory point of view. In an international transitioning market it appears to add additional complexity designing a TCF, which introduces a new range of risks to users and investors and an excessive administrative burden. In particular the possible future Brexit implementation options would need to be taken into account to assess the impact on TCF functioning with regards to UK-Continent or UK-Ireland interconnectors.

Tariff reform scenario

GIE would like to stress that the removal of IP tariffs may increase cross subsidies between domestic and cross border network users.

Zero tariffs at intra-EU-borders might easily lead to higher risk of capacity hoarding. The study already presents some reasons why the hoarding gas transmission capacity would be discouraged, but GIE still sees a significant risk that beneficial effects of this scenario will be absent if all gas transmission capacity will be inefficiently booked, allocated and used by a limited number of market participants. Furthermore, GIE expects that additional CMP measures will be needed.

The proposal to set intra-EU cross-border tariffs to zero will moreover imply:

- Zero tariffs at intra-EU-borders will most likely result in a change of flows. Given that the intra-EU tariffs will be zero, in case one market participant books all the capacity at one IP, the other market participants could easily find their ways by using alternative routes (e.g. loops) which would lead to a more costly use of the gas transmission system (gas moves

through longer routes instead of using the direct and shortest route). The study could consider the change on incentives for gas importers and the associated shippers to manage their capacity bookings and the impact on flows

- Zero tariffs at intra-EU-borders will ceteris paribus make it more expensive to transport gas over short distances. Compensating that effect – if required – via adjusted TCF mechanism bears the risk of non-neutral effect on TSO revenues
- The preliminary study indicates that the lost revenues from the intra-EU IP would be recovered by adjusting the external EU entry/exit tariffs at the external borders of the EU. GIE believes it is worthy also exploring the option of adjusting the domestic exit tariffs, in some cases wherever it makes sense avoiding cross-subsidization between transit and domestic users, so that TSOs can recover directly a bigger part of the lost revenues without having so much dependence on the TCF (reduction of monetary flows)
- GIE believes that removal of intra-EU tariffs could bring a potential risk of higher tariffs for certain consumers which would lead to final consumers switching to another commodity that appears more competitive
- Investment triggers for transit capacity would be distorted

As outlined above the establishment of some form of a TCF is also expected and thus the issues described earlier in this relation stay relevant for this scenario.

In the key characteristics of this scenario the entry/exit tariff for storages are set to zero within the current Regulation (NC TAR) which is welcomed by storage operators. For LNG terminals, there is a need for clarification on how they are treated in such a scenario, as they might, depending on the shipper, constitute an external entry point. The preliminary report describes “supplier specific EU entry tariffs” and indicates a potential differentiation of pipeline versus LNG based EU import tariffs. This needs to be further developed to fully take the important role into account, which LNG is playing with regards to pipeline gas pricing (see page 24).

GIE believe that storages at virtual trading point could have a substantial effect on market liquidity. It should thus be reflected in the analysis of the “Tariff reform scenario” where transport tariffs to storages are set to zero and consequently the capacity could be made available at the trading hub.

Trading zone merger

Market mergers are already possible under the current regulatory framework, since there are examples where markets have been merged within a member state (one regulator). However, there are limited examples of cross border mergers. The study could propose actions to promote and speed up the voluntary merge of trading zones through a bottom-up approach.

As outlined above the establishment of some form of a TCF is also expected and thus the issues described earlier in this relation stay relevant for this scenario. It needs to be ensured, that the different EU zones are not diverging too far from each other, fragmenting the internal energy markets.

Physical parameters of networks have to be included into the modeling, but also market realities such as contractual conditions as well as technical limitations which might have to be resolved with additional investments in order to ensure available capacity at all interconnection points. Furthermore, a larger market zone could lead to increased intra-zone congestions, an aspect which might require further investments.

Furthermore, this scenario will imply a harmonization of national laws and regulations in all the countries that will be affected by the merge; the complexity and feasibility of this harmonization, the governance of the new region (joint decision making of TSOs and NRAs), and the related costs, should be properly assessed in the following phases of this study.

The “Conditional market merger”:

This scenario could be implemented in a relatively short period of time, being the major regulatory change the set-up of a TCF between involved TSOs. This scenario would imply a relative low cost of implementation provided that both markets are very well connected. Additional measures may be needed to manage the capacity hoarding risk.

The conditional market merger will not be fully utilizing the synergistic effects such as cheaper daily balancing resulting from balancing only within one zone. However, we believe that the positive effect resulting from increased liquidity and competition on a wholesale level will compensate some downsides stemming from more than one balancing zones. This scenario is a relatively less complicated way to increase liquidity in a market with low liquidity that is next to a market with higher liquidity.

This scenario requires an elaboration of how the commodity and transmission capacity markets would be interlinked and organized in terms of maintaining separate balancing zones in a situation where transmission capacity is underutilized. Questions about how to determine the investments should be also clarified. There may be operational challenges related to the disconnection and reconnection of the market zones, in case of capacity congestion.

As outlined above the establishment of some form of a TCF is also expected and thus the issues described earlier in this relation stay relevant for this scenario, although the complexity is expected to be not as high given the low number of parties involved.

Furthermore, this scenario may also imply a harmonization of national laws and regulations in all the countries that will be affected by the merge; the complexity and feasibility of this harmonization, and the related costs, should be benchmarked against potential welfare gains.

The LTC gas delivered at EU border

This scenario implies contractual changes on the long-term supply and capacity contracts which might be excessively challenging. Whilst it would be more up to the midstreamers and producers to comment, from GIE’s side, we believe this scenario, if implemented, should be designed in a way which does not bring additional risks on infrastructure operators (e.g. due to reset of LTCs) and that revenues’ neutrality is guaranteed. Given that this scenario would cause more trading activities on the external EU borders, the impact on the liquidity of EU hubs (and the consequences this entails in terms of EU welfare) should be also assessed.