

Response by Europex

to the

**Public consultation by CEER on
“Draft Vision for a European Gas Target Model”
Ref: C11-GWG-77-03**

EUROPEX

Rue Montoyer 31 Bte 9

BE-1000 Brussels

T. : +32 2 512 34 10

E.: secretariat@europex.org

Europex welcomes the Public Consultation by CEER on a “Draft Vision for a European Gas Target Model” and thanks for the opportunity to take part in the consultation.

Enabling functioning wholesale markets

Q1: What are stakeholders’ views on the definition of a “functioning wholesale market”?

Europex agrees with the definition suggested by CEER but would like to complete it and emphasize on certain points which are also important to define a well functioning wholesale gas market.

A functioning wholesale market is a market where all the market participants (traders, shippers, etc.) can easily (with much flexibility) buy or sell (large) quantities of gas at a competitive price whenever they need some through any kind of trading form (OTC and exchanges) without having significantly influence on the price. Criteria to reach such a functioning wholesale gas market should entail the following conditions.

These are not limitative:

- Well-functioning gas transmission system/network in the concerned market: one entry-exit zone system within the hub served by the market, firmness of transaction on the hubs, market-based balancing system integrated within the wholesale market, etc.
- Competition in the wholesale market. One indicator could be the Hirschmann-Herfindahl Index but it has to be clarified (on purchases and sales in the wholesale market but also on cross-border capacity ownership).
- Liquidity in the wholesale market. In order to measure liquidity, the best measurement available addition of volumes traded on spot and forward/futures contracts registered by OTC brokers and gas exchanges (see insert below).
- Regulatory stability and compliancy with European regulatory framework
- Transparency and harmonized transparency requirements are of high importance for the proper functioning and development of a wholesale market. Data regarding the status of the network system (availability of network, consumption, imbalance) should be available near-real-time.

The two following criteria should be clarified and take into account the national conditions of the market.

- Different sources of gas are useful to achieve a well functioning wholesale market. However, it should be agreed upon what ‘different sources’ means. To our understanding it relates to a diverse upstream inflow of gas; which can be either locally produced or imported. More important is the ownership of these different sources; if they are one and the same, one could still speak of one source.
- The size of the gas demand (20 bcm/year as proposed) should not be a criterion per se. Smaller gas zones could be well functioning if there are well connected. Moreover, gas traded volume could be a better benchmark as part of assessing the functioning of the wholesale market (example of TTF)

Considerations on churn-ratios and measures of liquidity

In the definition of well-functioning wholesale gas markets, CEER refers to churn ratios defined as the ratio between traded and consumed volumes of gas. Europex welcomes this but would like to attract the attention of CEER of recurring misunderstandings in the definition of churns ratios in European gas markets and the indicators to measure liquidity. Furthermore, it is important to note that no scientific threshold exists to decide whether a market is sufficiently liquid (or not).

Indeed, in numerous publications, churn ratios are computed based on traded volumes reported by transmission system operators (TSOs). These volumes are actually not “traded” volumes but “nominated” volumes declared on the delivery day for scheduling and balancing purposes. This information thus corresponds to the net of transactions between pairs of operators and some the underlying transactions may have been contracted months (or even years) before through futures or forward contracts. Moreover nominated quantities to TSOs also integrate transactions between entities of the same group for accounting purposes.

Therefore, “traded” volumes reported by TSOs are not a measure of liquidity for a given month and does not represent anything objective. Moreover, churn ratios based on TSO data flattens the difference of liquidity between European hubs which many have a churn ratio around 2 and 3.

In order to measure or assess liquidity appropriately, several indicators are relevant such as traded volume on the wholesale market for a given month (OTC and exchange traded volume, where all traded volumes should be taken into account – spot and forward / futures trading), and also number of trading parties active on both sides (offer/demand), new trading parties, number of transactions concluded, price volatility, spread size per product, opportunity to trade derivatives.

Q2: What are stakeholders’ views on the three options identified to enable functioning wholesale markets, i.e. (i) creating market areas at national level for Member States able to meet the criteria of a functioning wholesale market; (ii) creating a trading region covering more than one country; or (iii) creating cross-border market areas?

- (i) Europex supports the principle of reducing the number of balancing zones within each European country in order to create national single entry-exit zones with a single hub and single balancing system.
- (ii) Europex does understand that market integration can be seen as the target model for gas, however where the conditions are not yet met to integrate two (or more) zones, market coupling can be a solution as intermediary option, were two zones are connected without merging them (see questions related to the 3rd paragraph).

- (iii) For small countries or where possible, creating cross-border market areas with a single balancing zone can be appropriate depending on the cost/benefit analysis results. Yet, on top of a deep cost/benefit analysis, those issues need very good cooperation between market parties and regulators. When market integration as such is not yet feasible, market coupling can be used to enhance trading and liquidity in such markets.

Q3: What are stakeholders' views on the proposed steps until 2014 for enabling functioning wholesale markets?

Europex agrees with the steps described in the paper. Indeed, this can demand a large cooperation between TSOs, regulators and gas exchanges with market support.

Connecting functioning wholesale markets

Europex agrees with the fact that implicit allocation of short term capacities – with a design adapted to the gas market – may be more efficient than explicit auctions as gas molecules and capacities allocation are coordinated. Short term capacities allocated by implicit methods may come from various origins:

- For uncongested points, unsold capacities;
- Proportion of capacity set aside for short term trading (if decided);
- Unused capacities if arrangements to free-up unused capacities like partial limitation of renomination rights are decided.

Europex welcomes the mention of implicit allocation methods in the Target Model. However, Europex recommends the Target Model to be less precise on the way to implement implicit allocation of capacities. In particular, reference to a specific platform which submits information to a market coupling algorithm is only one way of implementing market coupling mechanisms. As pilot projects just have started to be studied, the best way to implement such mechanism has still to be defined and the Target Model should only give general principles and be market driven. In particular, system organization inspired by electricity market coupling is not necessary relevant to the gas market.

Anyway, implicit allocation of capacities should be designed by Exchanges, TSOs and supported by market parties. Furthermore, the regulatory scheme applicable at national level, considering that in some countries institutional Exchanges are directly regulated by NRAs, should be taken into account.

The fact that shippers can change nominations during the gas day does not preclude any implicit allocation of capacities. The only issue could be that at congested points, if no capacities are reserved for short term trading and at least part of unused capacities are not released, there would not be any capacities left for implicit allocation mechanisms. Yet, a fully binding nomination right system is not necessary to have some capacities available for market coupling mechanisms.

The fact that gas is traded in a continuous way does not preclude implicit allocation of capacities either. Indeed, allocations could be repeated several times during the day. These allocation mechanisms can be applied not only in within-day markets but also in day-ahead continuous markets.

Q4: What are stakeholders' views on the full implementation of the CAM network code and the CMP guideline at all interconnection points by 2014 at the latest?

Europex agrees that CAM network code and CMP guidelines should be implemented according to the planned agenda.

Q5: What are stakeholders' views on the proposed pilot projects to design and trial an implicit capacity allocation mechanism between at least two entry-exit zones in different Member States by 2014?

Pilot projects and studies should indeed be encouraged in order to be sure to design a well functioning implicit allocation mechanism for the gas market.

Energy Exchanges would like or have to (accordingly to some national regulatory frameworks) play a prominent role in the further development of efficient market-based CAMs and CMPs and in particular on implicit allocation of capacities. Thus far allocation and trading of (secondary) capacity on exchanges (in addition to commodity trading) has proven to be beneficial to market parties. Knowledge and know-how of Exchanges in the gas market as well as in IT development and platform implementation should be taken into account to set up adapted implicit allocation of capacities mechanisms.

Ensuring secure supply and economic investment

Q6: What are stakeholders' views on the need for explicit long-term capacity allocation?

This question does not directly concern Energy Exchanges

Q7: How should economically-viable projects for cross-border capacity investments be determined?

This question does not directly concern Energy Exchanges

Q8: What are stakeholders' views on the proposed development of an economic test to trigger new capacity, based on market demand established through coordinated long-term auctions? If in favour, by whom and how often should such a test be conducted?

This question does not directly concern Energy Exchanges

Pricing of transmission capacity

Q9: What are stakeholders' views on the pricing of cross-border transmission capacity?

Tariffs are the essential link between the various elements of the grid codes, as they are the financial and economic signals which will influence behaviour of those using the system, as well as the behaviour of those who own and operate the system, the TSOs. And thus have impacts on the wholesale market including Exchanges.

Harmonisation and good allocation of tariffs are hence key for the development of a well-functioning gas market. It is generally important to have the right allocation of costs between market parties.

- Too high a reserve price for short-term capacities could hamper short term hub-to-hub trading and penalize some trading hubs that could become less attractive. If it is too expensive to transport gas to a peculiar hub, liquidity of the hub will decrease.
- Yet, Europex understands the problem of under recovery of costs by the TSOs. Impact of a zero-reserve price for short term capacities on TSO revenues should be studied carefully to avoid destabilizing the gas market framework.
- In some countries (e.g. Netherlands) some part of the hub services are not subject to tariff regulation. In light of the importance of the trading on a (virtual) hub in relation to physical gas transport, Europex deems it necessary that hub conditions including tariffs are subject to approval by the relevant regulator.

As far as Europex is concerned, short term capacities could be implicitly allocated even with a non-zero reserve price as long as the reserve price is not too high.

Renewable Integration and future challenges

Q10: Do you think that the elements of the gas target model provide a good framework for the integration of renewable energy?

As renewable energy is bounded to develop rapidly and knowing it is highly volatile and less predictable, short term energy markets will have to be more flexible and especially the gas market. That is why well-functioning markets with liquid hubs are all the more essential in an increasingly volatile context.

Q11: Are there elements missing in the target model that are necessary for the integration of renewable energy at a European level, possibly with a view beyond 2014?

Europex does not see any particular point missing on the subject.