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Self-evaluation of Austria's eastern market area in accordance with AGTM metrics and analysis of market integration options

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EFET comments – 31 March 2017

The European Federation of Energy Traders (EFET)[1] welcomes the opportunity to comment on the results of E-Control's studies.

Part 1: AGTM metrics update for Austria's eastern market area (self-evaluation)

1.1. Do the results of the study reflect your own appraisal of wholesale market competition and liquidity in the eastern market area (for the spot, prompt and forward segments)?

- We have no reason to doubt the results of the study.

1.2. The study finds that there is a lack of stable order book volume in the eastern market area, i.e. insufficient wholesale market trading. Which concrete measures could be taken to grow the order book volume and what effect would you expect these measures to have?

We observe that:

- The dual transmission and distribution balancing regime that applies in Austria's eastern market area was developed on the premise that Austria would form part of a wider trading region. The idea was that separating the two would, at least in theory, enable a harmonised system of transmission balancing to be applied consistently across all countries within the trading region, thereby concentrating liquidity, whereas distribution balancing could be applied separately based on currently prevailing arrangements.

[1] The European Federation of Energy Traders (EFET) promotes competition, transparency and open access in the European energy sector. We build trust in power and gas markets across Europe, so that they may underpin a sustainable and secure energy supply and a competitive economy. We currently represent more than 100 energy trading companies, active in over 27 European countries. For more information: www.efet.org.

However:

- When further exploring the means for markets integration the “trading region” concept was considered to be a far simpler and quick way of integrating markets than a full physical market merger, but this has not proved to be the case. Due to the lack of progress, attention seems now to have shifted towards developing a slimmed down version of the trading region concept (TRU) whereby network users would be able to exchange gas between Austria and Czechia (which are not physically connected at transmission level) on payment of a capacity upgrade fee. But this too seems to have suffered setbacks, not least of which is a complete disinterest from market participants who rightly argue that they can and already do provide such a service by way of gas swaps. Indeed TRU risks reducing liquidity in the Austrian market as it relies on TSOs (including the Slovakian TSO Eustream) manipulating shippers’ nominated flows to achieve an outcome that the market could achieve directly itself.

Therefore:

- In the context of the above we note that flexibility attracts liquidity (cf. the Dutch balancing system that includes Linepack services). Therefore we believe that at the moment E-Control has to prioritise the work towards a quick implementation of a new single integrated balancing system based on the provisions of the EU Balancing Network Code over further exploration of the options for the market integration. This should put an end to the inefficient and damaging practice of the Market Area Manager making ex-ante automated balancing interventions on shippers’ behalf which will lead to more efficient balancing and price responsiveness. Combined with a significant reduction in OTC transaction costs, we believe this will ensure the Austrian market is as liquid and competitive as it is able to be in its own right.

- Also, EFET welcomes the changes of integrating the activities of the Market Area Manager into the scope of AGGM in favour of increased synergies and simpler market design. We appreciate that ECA has made an effort to bundle similar tasks and data communication under a single entity to decrease the financial costs of operating the Austrian Gas Market. In this respect EFET would like to know the expected savings by this merger for the market and where these saved costs can be expected to be considered? Furthermore, does ECA envision to further merge market operation activities in Austria in the future, i.e. AGCS and CEGH, to further decrease costs and to make the Austrian Gas Market more attractive?

1.3. **The study considers that leaving the eastern market area to develop on its own will not be sufficient to reach the AGTM liquidity thresholds, i.e. that additional momentum from concrete enhancement measures is necessary. Do you agree?**

- Yes, we believe that specific measures for the eastern market area development (i.e. liquidity increase) should be taken. However, it does not mean that these measures should necessarily be integration-related or that work should start from here. This is not to say that we oppose integration. On the contrary, we support dialogue and cooperation among TSOs when this is aimed at promoting cross-border trade.

1.4. **To which degree is it feasible to compensate the lack of liquidity in the eastern market area's prompt and forward markets by tapping neighbouring market areas (e.g. the German market area NCG, which a Bundesnetzagentur study finds to clearly fall short of the AGTM liquidity thresholds itself)?**

- See our response to question 2.7.

1.5. **How important is a well-functioning wholesale market (in line with the AGTM definition) in Austria's eastern market area for the CEE/SEE region?**

- Austria has the potential to become a more liquid hub for hedging risks in the interconnected neighbouring satellite markets of the CEE/SEE regions, but possibly not to such a level envisaged for "functioning" markets in ACER's Gas Target Model as other neighbouring markets may share this role (e.g. PSV, NCG, Gaspool).

Part 2: Assessment of market integration options

2.1. **The study uses a number of criteria to compare and assess different market integration options. Are all of the criteria relevant? Which additional criteria would be needed?**

- No comment

2.2. **Which market integration option would yield the largest overall welfare gain for Austria's eastern market area?**

- No comment

2.3. Are there other geographical combinations that should be analysed? If so, which (larger) benefit for the eastern market area do you expect from these combinations?

- We believe that integration options with Hungary and Slovakia could also be considered. At the same time we acknowledge that there is no certainty, whether any such analysis will yield new insights.

2.4. Are there decisive benefit or cost types that are not addressed in the cost-benefit analysis conducted (or in the underlying assumptions)?

- Due to some assumptions, the cost-benefit analysis seems far too simple to take a decision for an integration based on the results:

  - It assumes that TAG Pipeline and its eventual expansion are a sunk cost with sufficient other supply to both IT and AT markets so that only a few restriction to capacity would be necessary in case of merger (i.e. a worst case scenario based calculation has not been carried out). At the same time, each other market integration combination provides a worst case scenario based calculation which removed most of the benefits of merging. As a result the AT/IT integration results may look brighter when compared to the other AT merger options.
  - Complementary services for restricting capacity measures (e.g. flow commitments, redispatch through linepack, grid expansion) were not analysed. However it is possible that the related costs of such services could be lower than the loss of benefits due to restricting capacity.

- Further details have to be provided in order to analyse how the charges, previously levied on the IPs between merged zones, would be recovered through the increase in charges at remaining entry and/or exit points of the new merged balancing zone.

- It is also crucial to ensure that even in case of overall “welfare gain”, there will not be a situation, where the benefits for consumers in one country are achieved at the expense of higher costs for consumers in a neighbouring market. Where such situation emerges appropriate inter-TSO compensation mechanism should be put in place.

- Finally, the analysis should also look at possible discriminatory consequences for market players in all markets considered in an integration/merger initiative with the aim to avoid any such discrimination or provide a compensation for it.

Notably on the benefits side there should be due account for the aggregation of storage resource, the relevant improved access to flexibility resources, as well as for the possibility to access alternative supply sources, including from LNG terminals.

2.5. The study states that any impact of market integration (i.e. of having larger entry-exit systems) on freely allocable capacity would be addressed by restricting capacity; it does not foresee that the currently available capacity could be maintained by applying complementary measures (which could range from flow commitments or redispatch through linepack to grid expansion). What are your views on the study's approach?

- Loss or degradation of firm capacity is an inevitable consequence of physical market integration as the larger the system the greater the risk of system congestion when investment to resolve internal congestions is not ensured. This aspect makes cooperation among relevant TSOs and National Regulators leading to any integration/merger initiative absolutely key.

- Market integration based on price harmonisation (see our response to question 2.7 below), i.e. by bringing down to 0 the reserve price for capacity at IPs, potentially overcomes this problem while allowing the possibility to continue revealing a congestion when a premium is expressed during auctions. Notably, such an intervention would have to avoid any potential discrimination towards existing users at relevant IPs and therefore it would have to imply a tariff equal to 0 for already booked capacity or alternatively a form of reset option.

2.6. The study outlines the effect of each market integration option on security of supply in the eastern market area. What is your opinion on these effects?

- Austria's abundance of storage capacity and import capability result in a high level of security of supply based on the stated metrics under each of the integration option. However, security of supply is best ensured through liquid competitive markets where supply and demand is balanced in response to undistorted price signals, so achieving this goal should take priority over any assessment based on metrics alone.

2.7. If Austria's eastern market area is to be integrated with one or several neighbouring market(s), which of the market integration tools (full market merger, different degrees of trading region) is preferable, taking into account both the potential gains and the complexity of implementation inherent in each tool?

- Instead of primarily pursuing full market merger or trading region options, E-Control should focus its attention instead on contributing towards a pan European initiative looking at integrating markets through EU wide principles.
- In this respect we note that tariff barriers that prevent gas flowing freely between market areas in response to changes in supply and demand should be removed so that prices in connected satellite markets can correlate and converge with those prevailing at a small number of highly liquid hubs.
- DG Energy's Quo Vadis study is expected to analyse in detail the costs, benefits and practicalities of pursuing such a radical new approach and we would encourage E-Control to actively engage in this study and any follow up pan EU regulatory initiatives that may arise from it.

2.8. What major barriers to market integration are there (legal/regulatory, commercial etc.) and how could they addressed in the eastern market area to enable integration with one or several neighbouring market(s)?

- E-Control has spent over 5 years analysing various options for integration of the Austrian market with the neighbouring ones (including Czechia and Slovakia). Therefore we believe that E-Control has first-hand experience and knowledge of the market integration barriers.
- Specifically and with respect to the TRU initiative the concerns outlined by the stakeholders in the process of the previous consultations are still in place.
- On the basis of the above we would like to highlight that the integration may prove equally challenging for different geographic combinations, however large the theoretical benefit.
- This said we appreciate that the IT/AT integration presents the advantage of having the same TSO (Snam Rete Gas) on both sides of the border. We also observe that Italy is already looking into alternative ways to facilitate price convergence across European hubs and we encourage Austrian stakeholders to establish an early dialogue with the Italian counterparts in this regard. In this context a price harmonisation solution – see answers to 2.5. and 2.7. – could represent a first step towards full market integration.