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EFET response to the consultation on gas capacity allocation and gas balancing - Circular de Acceso de Gas y Circular Balance de Gas

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EFET response – 5 July 2019

The European Federation of Energy Traders (EFET)[1] welcomes the opportunity to provide comments on the CNMC consultations on gas capacity allocation and balancing. For future reference, we suggest having such important consultations to be published in English, at least in the form of an Executive Summary, in order to allow better contribution from international companies, which is particularly important given Spain's significance in LNG markets. We thank the CNMC for the workshop and we wish that in the future such good initiatives will be open to all stakeholders to ensure proper understanding of proposals and earlier identification of unintended issues.

You will find below our comments on few of the changes proposed in the **consultation on gas capacity allocation followed by those on the balancing consultation.**

CAPACITY ALLOCATION

1. Monitoring of System Technical Manager and incentive/penalty scheme

The proposed framework will require detailed monitoring of the System Technical Manager's (GTS) coordination activities, as well as the development of a robust incentive and penalty regime to ensure that its actions are aligned with the interests of the market. This is key to ensure the success of the reform and to ensure that access to all services is not unduly constrained.

Without an effective framework, we believe there is a risk that the System Technical Manager may:

- under-allocate capacity to maintain more flexibility to manage congestion, leading to lower utilisation and increases in unit tariffs; or
- over-allocate capacity to maximise revenues but subsequently not being able to guarantee the firmness of some services.

We are particularly concerned about granting the System Technical Manager unfettered ability of refusing access to booked unloading/loading slots at specific terminals or redirecting cargoes. These actions introduce risks that are difficult to contractualise, impose costs on shippers and may occasionally disrupt commercial operations. These practices are a move away from a market-based framework so they should be taken only when absolutely necessary and accompanied by penalties for the System Technical Manager as well as compensations for the affected shippers.

[1]The European Federation of Energy Traders (EFET) promotes and facilitates European energy trading in open, transparent and liquid wholesale markets, unhindered by national borders or other undue obstacles. EFET currently represents more than 100 energy trading companies, active in over 27 European countries. For more information: www.efet.org

Clear and transparent rules to define congestion management at all terminals and a well-designed system of incentives and penalties for Enagás GTS are therefore essential to guarantee the integrity of the new regime and maintaining confidence in the Spanish market as a hub for LNG trading. We believe market-based mechanisms should be the preferred option used by the System Technical Manager to manage the system, whilst maximising infrastructure utilisation.

2. Offered services and products

On the offered services and products, we propose to further develop short and no-notice services for LNG storage and truck loading in order to increase the Iberian gas market flexibility.

In relation to bundled products, there is no clear rationale provided which justifies the 20 to 40 days duration of regasification capacities. We consider that, to make these bundles more useful and facilitate optimisation, the available regasification period should be up to 60 days. This is important to help reduce barriers to entry for smaller shippers until PVB gains sufficient liquidity to allow efficient hedging of spot cargoes. This will also enable shippers to procure standard duration capacity products (i.e. monthly and quarterly) to optimise their operations. Also, the rationale to limit the trading in the secondary market of the unbundled products is not conducive to the development of a secondary capacity market. We consider that shippers should be free to trade the unbundled constituent products as it will provide more flexibility for shippers to organise their operations and incentivises further utilisation.

To further streamline operations, we support to the proposal to offer transportation entry/exit capacity optionally bundled with regasification, liquefactions, and UGS injection/withdrawal capacities during the respective auctions. This is important to facilitate operations whilst minimising capacity mismatch risks.

On localised services, such as truck loading and reloading we would welcome further clarity on how the inexistent flexible characteristics will be accounted for and guaranteed.

3. Assignment procedures

The CNMC proposal states that yearly products (i.e. non-slot based) can be booked only once a year on a set date. We propose for yearly products a rolling-based booking system during every month for the following 12 months applicable from 1 Jan – 31 Dec paying the price of the yearly product (not 12 monthly products) to increase the flexibility of the assignment procedures.

In relation to daily products auctions, we propose that they should be held later in the gas day (i.e. after the close of the proposed 15:00 intraday power auction) as this has an unnecessarily adverse impact on CCGTs that operate as marginal units, which in turn, they likely affect electricity prices being paid by power consumers.

In relation to the transitional period, specifically the window of 10 days where shippers holding affected capacity can request for it to be transferred to other terminals, we would welcome further clarity on the following points:

- What is the process and timings?
- Where congestion arises through this process how will it be managed?
- Can the capacity be partially transferred? For example, where all capacity is held in Barcelona could you request that capacity is transferred 40% to BBG, 30% to Barcelona and 30% to Cartagena?

4. Congestion Management procedure and anti-hoarding mechanisms

As the proposal identifies, empirical evidence shows that there is a strong preference for certain terminals (e.g. Barcelona). This increases the risk of congestion both at that terminal and in the onshore transportation system. At the same time, there may be insufficient incentive to land cargoes at other terminals where they may be required to alleviate transportation congestion in the onshore system. A market-based regime would allow shippers/importers to reveal the value of capacity at congested terminals and to respond to commercial incentives to transfer imports elsewhere. However, the proposed scheme is instead highly discretionary on the part of the TSO and likely to lead to negative behaviours undermining the CNMC objectives of the LNG market reform. Namely we believe the proposed mechanism is likely to lead to:

- Unexpected increased cost and reduced operational certainty for LNG shippers who would consider setting European LNG operation in Spain. Hence, comparatively reducing the attractiveness of the Spanish market versus European peers.
- Reduced incentive to procure slots in the longer-term auctions i.e. over monthly for peak utilization months. This is likely to increase the complexity of efficiently managing the terminals and the virtualized LNG products.
- An increased risk premium being set on LNG slot operations in Spain, to account for the likelihood of congestion occurring, leading to comparatively higher prices for consumers.

To avoid these negative effects of the proposed regime, we believe that appropriate economic incentives and/or regulatory measures are instead used to increase the attractiveness of less utilised terminals, if this is necessary for the operation of the system. which would increase the geographic diversity of LNG deliveries, as discussed in our previous paper on how to improve LNG logistic in Spain[1]. Instead, we propose that a mechanism such as providing discounts at specific terminals would be most appropriate.

We seek more details on anti-hoarding mechanisms. Currently, a market player can only surrender its capacity as the only measure. If increased amounts of LNG coming to Spain creates more contractual congestion, then additional measures such as use-it-or-lose-it may be worth considering.

We are concerned by the low level of capacity reserved for 1 to 15 years, in particular for 1 to 5 years where it may prove insufficient to safeguard efficient access to capacity for all shippers. This concern doesn't only apply to regasification, tank storage and truck loading capacities, but all capacities available for over the 15 years.

We propose that higher proportion of capacities is reserved to be made available from the annual allocation period for the relevant year.

1 https://efetmembers.org/Files/Documents/DownloadsMember/EFET%20IGG%20discussion%20paper_Improving%20LNG%20logistics%20in%20Spain.pdf

5. Additional and transitional dispositions

We recommend that the entry into force should be slightly delayed to ensure the success of such an ambitious reform of the gas market. As highlighted in our aforementioned position paper on improving LNG logistics, we believe there are still merits in a gradual approach which is partly reflected in the transitional arrangements. We advise that the circular shall enter into force in its entirety, for LNG, in October 2020 This will also provide the sufficient time for Enagas to develop its operational proposals, the industry to review them and provide meaningful comments and run workshops allowing time for potential changes to be made.

6. Secondary capacity market

We regret to note that, as far as we understand, the draft *Circular de Acceso de Gas* does not address any of the issues we raised with the letter submitted to the CNMC last 26 February[2] in relation to trading and subletting of capacity in the secondary market.

In fact:

- whilst in our letter we requested the possibility for shippers to proceed with a transfer of rights of use ("*subarriendo de capacidad*") also for the IPs with other European countries (i.e. Iberico and Pirineos), in light of what is stated in article 2.2 the provision in Article 33.1 stating that capacity "*may be subject to sale or sublease to other subjects with access rights*" seem not to be applicable to said IPs with other European countries. Moreover, the same Article 33.1 unduly restricts the possibility for shippers to sell or sublet their unused capacity only to the *"capacity that has been assigned without additional premium"*;
- whilst in our letter we solicited that the capacity bought in the secondary market is invoiced with the tariff corresponding to the original contract, article 33.2 states that in any case of sell or subletting operations *"carried out by the total amount of capacity contracted or by a part thereof and by the total temporary duration contracted or by a part of it"*, "*these should be adjusted to the standard products of capacity contracting, and if this would result in products of shorter duration, these will be considered as such for all purposes, in particular, regarding the billing of tolls".* This proposed extension to the capacity subletting of the rules currently applied to the capacity assignments (which are already not common practice in Europe) is, from our point of view, undue and improper, in particular considering that in such cases the original holder of the capacity (i.e. the sublessor) maintains the obligation to pay the TSO for the total amount of the contracted capacity, including the subleased part thereof.

We deem that the implementation of such proposed rules for the secondary marketing of capacity would hinder both the optimisation of the use of the network and market functioning with negative outcomes on the liquidity of the Spanish gas market and on cross-border flows.

7. Linepack product

[2] https://efetmembers.org/Files/Documents/DownloadsMember/20190226-EFET%20letter%20to%20CNMC_Spanish%20Secondary%20Market%20for%20Capacity.pdf

Whilst linepack flexibility services are provided for in EU Regulation 312/2014 (BAL NC) EFET does not support their use, as they undermine the principle of daily cash out of imbalances and prevent system linepack being used collectively to the fullest extent by network users. Should the System Technical Manager bring forward proposals for a linepack flexibility service it would need to be consulted upon and clearly demonstrate compliance with the criteria set out in Article 44 of the BAL NC.

BALANCING

We are concerned in general with the level of unnecessary complexity being introduced which will increase the costs and risks of operating in the Spanish gas market which goes against of the objectives stated by the CNMC in the September 2018 consultation. In particular, the co-existence of multiple balancing regimes – at PVB, in LNG virtual tank, and in underground storage – is confusing and gives rise to unnecessary penalties. We consider that a simpler robust penalisation and congestion management regimes – such as storage overrun charges and rejection of invalid nominations - as are found elsewhere in Europe, provide sufficient incentives for participants to operate within their contracted capacities.

Therefore, it is very important that the problems are addressed by the most appropriate solution, not trying to fit a defined solution to the problem therefore the CNMC should consider the following:

What are the TVB and AVB proposals try to solve?

It is our understanding that the proposed TVB and AVB balancing frameworks seek to incentivise appropriate behaviours from shippers in relation to the utilisation of the respective storage capacities. Specifically, two behaviours are aimed to be disincentivised:

- **Overrunning contracted storage capacities** – currently there are problems being created in the UGS and LNG tanks where shippers continuously overrun their contracted capacities, as the penalties are not dissuasive enough.
- **Holding a negative gas stock** – Shippers being able to withdraw more gas than they own in the storage facility.

What are the drawbacks of the proposed TVB and AVB regimes in addressing these problems?

Potential for arbitrage by traders/shippers of the TVB and/or AVB with the PVB – As the SO will balance the TVB and AVB positions at PVB the day after i.e. D-1 it exposes the proposed regime to potential arbitrage by shippers. Scenarios where shippers create a short/long position to arbitrage would be:

1. **Scenario where a short position may be created (price in D > D-1)** – The incentive will exist where a high price differential where the price of gas in D is expected to be higher by at least the value of the small adjustment (i.e. 5%) than the expected price for D-1. Leading to a net positive margin between the prices at which the gas was sold

by the shipper in D, versus the MBP based on D-1 prices. Therefore, shippers will have an incentive to go short in the TVB and AVB and to be able to sell more gas than in D to obtain the net margin.

2. **Scenario where a long position may be created (price in D < D-1**) – The incentive will exist where a high price differential where the price of gas in D is expected to be lower by at least the value of the small adjustment (i.e. 5%) plus the penalties than the expected price for D-1 is. Leading to a net positive margin between the prices at which the gas was bought by the shipper in D, versus the MSP based on D-1 prices. Therefore, shippers will have an incentive to go short in the TVB and AVB and to be able to sell more gas than in D to obtain the net margin.

The materialisation of either scenario, if large numbers of shippers identify it, may lead to the SO facing operational challenges to be able to fulfil the operations not backed by gas, or at least increase the costs of managing the system which will affect all participants and ultimately consumers.

Potential for inefficient operations by the SO – The currently proposed framework provides the SO with an undesired level of discretion to manage the Spanish gas system, which is likely to be of detriment to the market leading to inefficiencies across the gas system. Two concrete examples are the lack of ex-ante transparency of the SO operations to shippers limiting the effective operation of the market and reduced effectiveness of the PVB imbalance price signal.

The complexity of the regimes plus the apparent significant amount of discretion given to the SO will limit the transparency of the SO actions. Transparency which would otherwise provide information to the market to react to the available information. For example, even though shippers may expect the PVB to be short today, this may or may not be the case dependent on the actions that the SO will need to undertake to balance the TVB and/or AVB.

Similarly, to the example above, the operations which the SO undertakes today to balance yesterday's TVB and AVB positions mean will alter the imbalance position and hence prices of today's PVB. Therefore, artificially changing the balancing signal which the SO actions are expected to send to shippers through the expected MBP and MSP imbalance prices. Moreover, as shippers on the day will not know which SO actions are attributed to which balancing point limiting their ability to react.

What are the best solutions to address the problems?

We do not consider the proposed solution to be the best alternative to address the behaviours of overrunning contracted storage capacities and holding negative gas stock positions. These issues have traditionally been addressed across Europe by two regulatory regimes. These are broadly defined as penalties for capacity over-utilisation and the SO baring nominations by shippers which will take their gas below zero.

On the one hand in relation to the overrunning contracted storage capacities issue, the penalties associated with over-utilisation of capacity can take many forms including multiples of DA tariffs costs, which are mentioned in the proposal, to other financial penalties set administratively. The key characteristic is that these penalties need to be significant enough to act as deterrent to over-spilling. For example, a cost relative to the PVB.

On the other hand, in relation to the issue of shippers withdrawing more gas than they have stored, this can simple be prohibited. Not only by making it explicit in the regulation that this

behaviour is not allowed, but by requiring the SO not to accept withdrawal nominations which take shippers holdings to negative values.

However, if the CNMC decides to implement their proposed approach at a minimum it should take the following points into account:

1. **Changes to the 'small adjustment'**

The proposed increase from 2.5% to 5% is unnecessary and counterproductive to increase the attractiveness of the Spanish market. Whilst it will not deter fraudulent actors as those seen in late October, it unfairly penalises shippers who participate actively in the market. This turns out to be a measure which increases the costs of operating in Spain which will deter participation and translate to higher prices for Spanish consumers.

2. **Positive values from balancing actions**

The proposal maintains that the positive monthly balances of monthly balancing actions are kept for a calendar year, then these are included in the system revenues. As these are revenues obtained through the SO marginal balancer role to ensure the safe operation of the system, any surplus should be returned to shippers on a monthly basis. Absent this, the net position should be returned at the end of the year with interests.

3. **Effective SO incentive framework**

We consider of paramount importance that an effective incentive and disincentives regime to be developed by the CNMC with market agents' involvement. This to ensure that the SO actions are the most conducive to minimise any distortions to the operations of the market and minimising the explicit costs of its actions. In short, the SO should only take buy/sell actions when congestion issues arise with these being at the lowest possible cost.

4. **Guarantees**

In order to manage the proposed guarantees regime, a fully automated system such as that at an exchange (i.e. meaning recalculation of guarantees during the day) would be necessary to make these operations more efficient. This way it provides shippers with the whole of the next gas day to update the guarantees. We would also welcome further clarity on the interactions between MIBGAS and Enagás regarding the joint administration of guarantees.

As a final remark, we recognise the haste with which CNMC is working to try to complete a round of complex reforms being delivered through a number of circulares and later detailed design documents, which are interdependent. It is therefore not possible to comment on all aspects of these particular documents prior to sight of the whole package. Even then, it is not possible to foresee how the TSO will exercise the significant discretion allowed to it. In this light, CNMC is advised to build a formal review into the proposals and a governance process that allows modifications to proposals that do not serve the interests of the Spanish market.