

EFET Comments on Gas Storage Capacity Allocation



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General comments:

The European Federation of Energy Traders (EFET)¹ welcomes the opportunity to provide suggestions concerning the procedure of gas storage allocation in Italy for the year 2014/2015.

In the past, EFET has on several occasions insisted on the need to introduce competitive mechanisms for the allocation of gas storage capacity, such as auctions. We are, in fact, convinced that this solution is the most appropriate to provide market players with the right signals of scarcity and to allow better functioning of the wholesale gas market and a more accurate assessment of potential new investments in storage facilities.

Improvements to the current design are necessary

A competitive auction design must necessarily be associated to flexible capacity products. Storage capacity must in fact be associated to **flexible injection and withdrawal profiles**, both in order for market participant to manage situations of system stress efficiently and to maximise shippers' participation.

In order to make storage truly attractive for shippers, the current restrictions to the withdrawal and injection services associated to storage capacity should be removed starting from this year's products, as they strongly jeopardise the commercial value of storage for shippers and, as a consequence, shippers' interest in participating in the auctions.

As an example, the "*uniform service*" storage capacity product offered in the previous storage year to all market participants and associated to a constant withdrawal profile, was not of interest for the majority of market participants, even with a zero reserve price as the auction base price, because of the lack of flexibility associated to the injection and withdrawal services. As a result, almost 67% of the 1.7 billion cubic meters of capacity offered was not allocated.

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

Furthermore, it is very important to consider that this year the difference between the regulated storage tariff and the allocation price was borne by natural gas importers and producers through the so-called “CV_{os} component” in gas tariffs, which applies to any volumes of gas injected into the Italian network, with an evident cross-subsidy and extra-burden upon gas importers. It also gives an implicit competitive advantage to vertically integrated companies, as they are able to pass on end customers the import costs while other companies will be naturally subject to losses.

Such additional component constitutes one of the main barriers for any energy company to operate into the Italian market and must be removed from the entry points as it distorts price signal on the Italian market and hampers an efficient development of the Italian market².

Current low value of gas storage is a European-wide phenomenon linked to a series of complex market changes, which deserve close attention and more structural regulatory intervention than a repeated increase in import and storage tariffs. EFET is open to discussion with Italian institutions on how to tackle this issue, although this warrants a longer timeline and should not affect the upcoming allocation procedure.

Response to the specific questions asked during the January 23rd meeting:

1. Preference between all capacity to be auctioned or part of it to be allocated pro-quota

EFET strongly supports market mechanisms for the efficient allocation of storage capacity via **auctions**, open to all market participants.

In our view, only non-discriminatory and market-based rules for the allocation of storage capacity will reveal the true value of gas flexibility.

Equally, auctions will enable market participants to acquire storage capacity which reflects the unique characteristics of their portfolios - which may comprise industrial customers, households, power plants or traded market activities.

Also, EFET does not support discriminating access to storage capacity via pro-quota allocation open to only one market segment. Besides, users accessing storage capacities via the pro-rata mechanism must pay the whole regulated tariff, regardless of the output of the auctions.

Finally, EFET would like to point out a potential distortion of the auction system if participants to the pro-rata allocation subsequently place bids to the effect of reducing the overall allocation price.

² The CV_{os} tariff was increased from zero to 0.00095 €/scm for the first quarter of 2014 and communicated only few days in advance. Furthermore, it will be subject to further increases - e.g. it might be increased by 80% and even further - during 2014 on a quarterly basis in order to recover Stogit's under recoveries. The sum of the additional components that apply at the entry points - and not related to gas flows as they constitute subsidies to e.g. storage, LNG, interruptible customers - frequently overcome the difference between the price at the PSV and the hub prices in the neighbouring countries. Vertically integrated companies are able to pass such additional fees directly on end customers while non-vertically integrated companies are subject to losses. As a consequence, such fees give an implicit competitive advantage to vertically integrated companies, while the other companies will not be willing to operate into the Italian market because of such uncertainties or would be only willing to flow gas into Italy at a risk-premium price that covers the regulatory risk of the frequent increase in cross-subsidies applied to importers, such increasing the price for the Italian end customers and hampering the development of the PSV.

2. Auction design

EFET is in favour of having single auctions for each of the different products. Auctions may be differentiated and scheduled per type of product (GNL services, peak modulation, etc.) or according to a seasonal approach.

However, it is fundamental that all rules are known before the start of the auction process to all market participants, and that there is no unexpected change in allocation or pricing mechanism after the process has started. Each product should ideally be auctioned only once for the whole storage season. In case more than one auction is held, it should be announced in advance and auction rules and prices should be the same.

Regarding the price rule, we believe that the reserve price should be designed as to allow extracting the full value of storage in the auction and that in no case it should represent a market distortion. Our preferred option in this case would be not to adopt a reserve price (“base d’asta”), or, equivalently, to apply a reserve price such as **the sum** of the storage tariffs (f_{pe} , f_{pi} , f_s , US_1 , US_2 , CVS) equal to zero. This would guarantee a larger participation of shippers in the auction and avoid expectations of reduction of the reserve price in following rounds. This point is key to ensure an adequate allocation of storage space, with positive consequences on the security of the system.

Regarding the total revenues generated by the mechanism above, we believe that higher reserve prices might cause even lower returns simply by reducing demand and thus reducing the total space-quantities allocated.

Furthermore, as already mentioned, a deeper reform of the storage products offered is essential to guarantee that storage capacity is associated to flexible withdrawal and injection services.

However, the redesign of storage products and injection/withdrawal profiles should not excessively delay the publication of auction rules and deadlines as market participants need sufficient time to understand products and evaluate potential bids.

3. Integration of storage with other sources (such as LNG) as to allow more flexibility

EFET believes that there is certainly a need for Stogit and for the Institutions to start a process for offering different types of products with different flexibilities. This process, including at least a market test, should however start well in advance before the yearly allocation process.