

EFET response to AEEG DCO 330/2013/GAS “*Criteri per la determinazione delle tariffe per l’attività di trasporto e dispacciamento del gas naturale per il quarto periodo di regolazione*” – determinazione dei corrispettivi tariffari.

EFET¹ welcomes the opportunity to provide further input on the determination of the gas transportation tariffs for the fourth regulatory period (2014-2017). EFET appreciates the willingness of the AEEG to ensure greater transparency in the process of determining tariffs, providing for the publication by Snam Rete Gas of all the relevant information for the tariffs’ calculation.

As stated in response to the DCo 164/2013/GAS, we agree with AEEG that “*the convergence between European and Italian tariff criteria is an essential prerequisite for the development of an internal energy market*” and we welcome the reference to the EU Framework Guidelines on Harmonised Tariff Structures currently being finalised by ACER, which will result in an EU Network Code (Tariffs NC). We believe that this is important in light of the expected implementation of the Tariffs NC by the end of 2017. We are convinced that taking into account the main provisions defined in the Framework Guidelines from this stage will facilitate a smoother transition and an easier implementation.

Therefore, we welcome the further details provided with the current consultation on the specific aspects of the tariff structure, which are indeed very relevant for the day-to-day business of EFET members.

➤ **Capacity fee covering operating costs (S1)**

EFET welcomes the re-orientation towards capacity charges of all costs that are not driven by the volumes of gas actually shipped, as foreseen in the Tariff Framework Guidelines. We note, however, that such a fundamental change must be introduced with a longer advance notice period; otherwise, in an initial period, this change may reduce the competitiveness of the Italian wholesale gas market by increasing the initial cost (capacity fee) to be incurred to deliver gas at the PSV for those shippers holding long-term capacity contracts.

In order to mitigate this negative effect, we propose AEEG to consider a change in the entry/exit split to favour cross border trading and the alignment of prices between adjacent hubs. The costs associated with the estimate gas flow in peak consumption should be allocated predominantly to *exit* points.

Taking into account that gas flows at the entry points are mainly characterized by stability and that the related investment on the gas transmission network is not “dedicated”, as for exit points, we consider that an entry-exit split providing a greater share in cost sharing for exit points could be appropriate, especially in those systems like Italy where the centre of greater consumption is geographically dislocated with respect to the position of some entry points.

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 120 energy trading companies, active in over 27 European countries. For more information: www.efet.org

Furthermore, EFET believes that the introduction of a solely capacitive tariff along with the new capacity allocation methodologies, as proposed in the consultation 317/2013 in consistency with the CAM Network Code and the CMP Guidelines, significantly reduces Snam's entrepreneurial risk and the incentive for the TSO to provide an accurate forecast of the expected booked capacity. For this reason we suggest to significantly reduce the *equity risk premium* (ERP), hence limiting Snam's revenues.

Furthermore, the introduction of capacity charges regardless of gas flows makes it even more essential to introduce a modification of the criteria currently used by Snam Rete Gas to curtail nominations at entry points during scheduled maintenance or interruption of import pipelines. Under these circumstances, it would be appropriate to eliminate the rule provided by the Network Code that envisages a pro-rata curtailment of nominations of all network users, irrespective of their will to import of gas in that period². This kind of provisions artificially limits supply to the Italian market and consequently increases wholesale market prices.

➤ **Matrix methodology/virtual point based methodology (Ref. S3)**

AEEG proposes two methodologies, one with an 'extended matrix' and the other based on a 'reduced matrix'. The extended matrix methodology appears to be the preferable option. However, further transparency on the calculation method should be provided. Also, a reference scenario for the simulation of gas flows should be evaluated, taking into account *an average of days of peak flow*, rather than based on the *single maximum peak day* (in January) because this seems a more plausible situation. The result should then be checked with the network's portability.

Moreover, the current Framework Guidelines on rules regarding harmonised transmission tariff structures provide for NRAs to publish all relevant information to be used for at least two methodologies, as well as the cost allocation test and its outcome. NRAs shall also publish for public consultation a detailed explanation why a cost allocation methodology is selected: this would be important in order to highlight the impact that the proposed methodologies will have on the evolution of tariff levels. In particular, EFET believes that projected tariff evolution should always be shown at individual entry/exit point level, as to enable network users individually to understand exactly how they will be affected by each methodology.

➤ **Multipliers and alternative approach (S7 and S8)**

Concerning the proposed multipliers, whilst we understand the need to struck a balance between ensuring that a sufficient amount capacity is booked for the long and the short term, the proposal to increase the multiplier for *daily capacity* to 1.5 (from the current monthly 1.4 re-proportionated on a daily basis) is likely to negatively affect the allocation of daily capacity

² More precisely, in EFET's opinion, if a maintenance is planned and the total capacity is expected to be reduced by x% but the actual nominations are below (100-x)% of the total capacity, no curtailment on shippers' nominations should occur. Curtailing of the individual nominations on a pro-rata (of the booked capacity) basis should occur only in the event that actual aggregate nominations exceed the remaining firm capacity during maintenance.

and the benefits that the Italian market has experienced after the introduction of day-ahead capacity allocation in particular at Tarvisio/Arnoldstein.

The alternative approach proposed by AEEG to apply the capacity charge on the *maximum* capacity used during the year does not appear reasonable. On the contrary, it seems rather peculiar in the European context and it does not provide any type of incentive to optimise the utilisation of cross border capacity according to the needs, therefore EFET does not support it. Furthermore, the alternative method seems equally questionable with regard to exit points, because it does not represent a solution to provide more flexibility to the network users and it could penalize customers with a variable consumption profile.

➤ **Allocation of fuel gas, unaccounted for gas and losses (S13 and S14)**

EFET has raised concerns about the method to allocate fuel gas to network users during the current regulatory period³. Indeed the requirement to modify the nominations at the entry points by a *percentage* (between 0.003% and 0.13%), creates fractions that are not tradable at the PSV. These fractions create a fictitious imbalance, in particular for those shippers/traders not having storage capacity, which can be settled only through the balancing market, although these fractions are not due to proper imbalances. Again, this creates additional risk and operational burden to importers selling gas at the PSV. According to the analysis performed by EFET, there are no similar cases in north-west Europe about the allocation of fuel gas in kind to shippers.

In consideration of the elements above, we urge AEEG to revise the mechanism by requiring to Snam Rete Gas to supply the gas needed for these purposes through market mechanisms, namely via tenders. This is a mechanism widely used in Europe and it may allow AEEG to introduce *market based* mechanisms to ensure efficiency in the supply of fuel gas.

Moreover, EFET companies would ask for more transparency on the values assumed, also with reference to past Gas Years, by fuel gas, unaccounted for gas and losses. Similarly to what is proposed by the AEEG in the previous consultation document on gas losses, we believe it would be appropriate to define incentivizing mechanisms for the TSO aiming at achieving a progressive minimization of all these quantities, to bring them to an expected value around zero, in order to empower both the TSO and the owners of the city gates in their activities.

➤ **Additional Variable charges**

We noted that the consultation paper 330/2013 does not mention the intentions of AEEG regarding the *supplementary charges*⁴. Such charges *are required* to be paid by shippers to flowing gas into Italy and therefore they should be taken into account by AEEG when determining the overall tariff levels, even though they are not revenues for the TSO.

The supplementary charges have been increasingly used as a quick fix to solve issues totally unrelated to gas flows into the Italian system. Therefore EFET urges AEEG to remove, together with the variable charges, also these additional 'duties' based on the

³ See attached documents

⁴ 'Componenti tariffarie relative agli oneri aggiuntivi'

volumes flowed at the entry points. Indeed these charges have a damaging effect on cross-border trading, liquidity and competitiveness of the PSV. A significant distortion is also introduced in the competition in the wholesale market between market participants vertically integrated that can pass-through these additional charges to end users and those market participants active only in the wholesale market.

In particular, importers selling gas at the PSV are highly exposed to these additional charges. We would like to emphasize that contractually – we refer primarily to EFET master agreements widely used across Europe – market participants *cannot* pass-through these additional charges to their counterparties.

The negative effect is exacerbated also in reason of the method used to introduce and update such charges. Indeed, where the *base* transportation tariffs are calculated and updated on a yearly basis – in consistency with contractual commitments of market participants – the *supplementary* charges are updated on a quarterly basis and can be introduced *at any point in time*. The main consequence is that market participants willing to flow gas to the PSV will do that only with if the market price will be high enough to consider transportation costs *and* an additional *market premium* due to high risk of operating in such an environment. This has obviously detrimental effects on the overall welfare achievable in the Italian wholesale market.

Hence, EFET believes that it is far more appropriate that funds that need to be recovered for various reasons are applied to exit points associated with end users. The introduction of such change should be deliberated sufficiently in advance with respect to the beginning of the Gas Year, in order to allow operators a correct transposition in supply contracts related to the same Gas Year.

Fuel gas methodology and issues for traders

Description

AEEG's decision ARG/gas 192/09 modified the methodology used to attribute unaccounted for gas (GNC), fuel gas and network losses to the daily balancing equation for shippersⁱ.

Notably, the revised equation allocates predefined quantities of fuel gas, network losses and unaccounted for gas to each individual shipper, based on a set of coefficients for entry/exit points to the system. These coefficients are approved yearly together with transportation tariffs. The coefficients were approved for the first time by ARG/gas 198/09 and are defined in Table 3.1 of this decision.

The decision was welcomed by shippers because, until then, unmeasured gas (GNM) had been attributed in a non systematic way. The previous methodology caused *unpredictable* imbalances. EFET appreciates the revision of the system in this regard.

Nevertheless, we would like to bring your attention to an additional issue that the new methodology results in for traders at the PSV.

We also underline that additional *unpredictable* imbalances may arise due to differences between the *expected* and the *actual* Gross Calorific Value (GCV). Shippers are required to nominate the expected energy on d-1 taking into account an estimated GCV, but the final allocation the energy injected is obtained applying the *actual* relevant Gross Calorific Value, which is known only after the measurement.

Although the short analysis below is focussed on the fuel gas regulation, effects on traders are similar in case of GCV adjustments.

Effect on traders

Nominations will inevitably be imbalanced by a fraction of standard traded volumes, as a result of the revised balancing equation.

To illustrate the effect of the revision, consider an importer that sells all gas imported at the PSV and that volumes traded at the PSV are standard volumes. The shipper in this example imports 100 GJ at the Entry Point Passo Gries, where the fuel gas coefficient $\gamma_{\text{FUEL}} = 0,110346\%$.

The result of the balance equation will be the following:

$$DS = -(-100) - (1 - 0,110346\%) * 100\text{GJ} \rightarrow DS = 0,110346 \text{ GJ} > 0^{\text{ii}}$$

ⁱ The shipper's balancing equation is described by the following relationship:

$$DS = (1 + \gamma_{\text{GNM}}) * P - T - \sum_{\text{NE}} (1 - \gamma_{\text{FUEL,E}}) * I_E$$

DS = disequilibrium

γ_{GNM} = Coefficient for redelivery points on the regional network, or 0 for other points. (This adjusts for network losses and unaccounted for gas.)

$\gamma_{\text{FUEL,E}}$ = Coefficient for particular entry points. (This adjusts for auto consumption.)

P = Off takes; T = Net transactions at the PSV; I_E = Injections at a particular entry point; DS = Result of the balancing equation.

ⁱⁱ P = 0

Given the absence of an offsetting adjustment to volumes traded at the PSV, the coefficient results in an unbalanced position for the shipper.

What is more, the magnitude of the imbalance that results is impractical. The volume cannot easily be traded, because it is a fraction of standard traded volumes.

This issue is relevant for shippers with no access to gas storage. For shippers with storage capacity available (i.e. shippers that directly or indirectly serve end users), this issue does not have a practical effect. This is because, as a result of the balancing regime, unbalances are covered during the settlement. Shippers without storage capacity, on the other hand, face this problem.

For those shippers, the quantities that need to be taken into account in daily nominations are impractical. Contractual arrangements would be possible in principle, but, indeed, they are unfeasible, since they would refer to non standard quantities and result in an unfair practical barrier for new entrants.

Thus we ask AEEG to reconsider this methodology.

To offer our support, we performed a short analysis on the practices in use by other TSO in different European countries. Please find the results summarised in the table below.

Country	TSO/Grid	Methodology
UK	IUK – Interconnector	IUK applies a fixed percentage to net deliveries ex ante, which is then adjusted on a weekly basis for actual volumes. (Note that this does not provide a direct parallel to Snam's application of an adjustment to entry points and to redelivery points to the regional network.)
Belgium	Fluxys	Fluxys adjusts offtakes at the exit points only.*
Netherlands	GTS	Specific contracts for gas used at compressor stations and for network losses are in place. Unaccounted for gas is handled through operational balancing agreements with the neighbouring network operator
Germany	Open Gas Transport (previous E.ON Gas Transport)	Gas is supplied by shippers through tenders and/or by bilateral transactions; fuel gas costs are covered in the Transportation Tariffs.
	Wingas	Gas is supplied by shippers through tenders and/or by bilateral transactions; fuel gas costs are covered in the Transportation Tariffs.
Denmark	Energinet	Energinet sells/buys gas to balance the system for losses, fuel gas, and unaccounted for gas. Costs of these volumes are covered in transportation tariffs.
France	GRT Gaz	Gas is supplied by pre-qualified shippers through annual consultations.

* Fluxys is, however, in the process of phasing this out.

Two European gas transporters, other than Snam, (IUK and Fluxys) apply adjustments to the shippers' balancing equation to account for the gas volumes in question. Other European transporters handle these volumes by other means.

Based on this brief description of methods used, we suggest a few options that we would like to discuss with you:

- The adjustments for fuel gas could be applied only to system offtakes.

The principle of this methodology would be consistent to the final destination of gas and with the availability of gas storage for those shippers that manage offtakes of final customers.

- Fuel gas and differences in expected and actual GCV could be handled with OBAs with neighbouring TSOs.

This would remove the adjustments for these gas volumes from the shippers' balancing equation, but still allow Snam to balance the system.

- Fuel gas could be supplied on a system level by shippers through tendering processes. The cost incurred by Snam could be recovered fully through transportation tariffs.

This would remove the adjustments for these gas volumes from the shippers' balancing equation, but still allow Snam to balance the system.

Fuel gas could be subject to a price-cap and fully recovered through transportation tariffs.

- Alternatively, Snam could offer a service with which shippers could balance fuel gas imbalances and differences in GCV. As in the previous option, costs incurred could be recovered through transportation tariffs.

More generally we suggest that the issues highlighted shall be solved through the process to revise the balancing regime, planned to come into force in April 2011.

We think that the removal of these “technical” impediments will reduce uncertainties for shippers in the allocation process and thus will incentivise new entries and a more efficient use of cross border interconnection points.

EFET response to the consultation paper

“Sviluppi della regolazione dei servizi di trasporto e bilanciamento, stoccaggio e distribuzione del gas naturale per lo sviluppo del mercato all’ingrosso e al dettaglio” –
DCO 25/10

EFET promotes and facilitates European energy trading in open, transparent and liquid wholesale markets, unhindered by national borders and obstacles. EFET strongly maintains that by ensuring shippers and traders are able to efficiently intermediate in energy value chains supply and demand will be optimised in the most economically efficient manner and security of supply will be enhanced, to the overall benefit of the economy and society.

EFET welcomes the AEEG’s consultation paper DCO 25/10 focussed mainly on a reform of the gas balancing regime and sees this as a positive step towards achieving greater efficiency and liquidity in the Italian gas market. The consultation recognises that changes are likely to be required as a consequence of the European Framework Guideline and Network Code on Gas Balancing resulting from the 3rd Energy Package, and the consultation should be considered in this context. However it is important not to lose sight of the fact that other aspects of the Italian gas market particularly access to transportation and storage capacity will significantly affect the success of the reform of the balancing regime and the efficiency and liquidity of the market as a whole.

To this extent, whilst we have provided detailed comments below on issues raised in the consultation paper, we think it is helpful initially to lay out our view of what we consider a model that can be identified as a target for Italy. We also suggest some possible measures to allow its achievement.

We would very much welcome the opportunity to discuss this with you in more detail along with how changes to the balancing regime can effectively be implemented within this model and which transitional measures EFET believes are reasonable.

**A TARGET MODEL FOR THE ITALIAN GAS BALANCING REGIME – EFET
VIEWPOINT**

EFET believes that Italy already satisfies a number of preconditions for development of a successful wholesale gas market namely:

- pipeline gas is plentifully supplied from a number of different producing countries via mature interconnector pipelines, and new sources and interconnectors look likely in the medium term;
- two LNG Import facilities currently exist and new facilities look likely in the medium term;
- small but significant indigenous gas production;
- a single TSO covering around 95% of the transportation network;
- no physical transportation capacity congestion;
- gas demand is relevant, particularly from the power generation sector;
- abundant gas storage capacity with plans to invest in a further capacity in the mid-term;
- a virtual trading point at the PSV with its own appendix to the EFET Master Agreement;
- a reasonable number of supply and trading companies operating in the market;

- an ongoing process to assign the responsibility to meter and install new meters at all city gates.

However, in the current regulatory framework relevant changes are needed to fully realise the benefits of competition in the wholesale market and allow access to new entrants. EFET believes that a full implementation of the proposed target model is achievable in the next 2-3 years if a concrete roadmap is identified.

Short term access to import pipeline capacity

The ability to trade short term transportation capacity on the secondary market is restricted due to operative constraints and the current balancing framework. Consequently, a party's ability to react to changing demand within day is hampered, limiting the possibility to balance its portfolio and increasing its risk of being exposed to imbalance charges which it can do little about.

In order to stimulate competition and precipitate conditions whereby market parties are better able to balance their own portfolios and trade gas at the PSV, we believe that in a view of a target model AEEG should give consideration to:

- requiring the TSO to undertake short term capacity auctions of relinquished and unsold import capacity in line with arrangements laid out in the EU network code and building on work done in relation to Delibera ARG/gas 116/10;
- requiring the TSO to facilitate the efficient recording of secondary capacity trades and assignments.

Access to Storage Capacity

Due to provisions included in primary legislation suppliers have the obligation to provide their customers with a seasonal modulation service. Thus AEEG rules provide that access to storage capacity is allocated with priority to those suppliers supplying households and smallest end-users. This precludes its allocation to traders, power generators and industrial customers. New entries in the market should instead be encouraged. At the same time the optimisation benefits arising from storage capacity cannot be fully realised due to the fact that balancing resources are not provided efficiently.

In the current balancing regime storage is used exclusively by the TSO to balance the system, suppliers are not fully in control of their injections and withdrawals from storage (i.e. balancing "with storage" rule) and storage overruns are particularly penal. Additionally interventions from the Ministry require certain levels of stock to be kept in store at certain times.

In order to stimulate competition and precipitate conditions whereby market parties are better able to balance their own portfolios, and trade gas at the PSV, we believe AEEG should give consideration, whilst taking into account expected effects of Legislative Decree n.130/2010 (as explained below) to:

- promoting a non discriminatory access to storage capacity to allow all traders, shippers, suppliers and end users (such as power generators) to acquire capacity directly - ;
- adopt rules to require storage operators to offer a certain percentage of existing storage capacity to all market participants through market based mechanisms at least in yearly strips;

- signal to the Government the need to review the scope for governmental intervention in storage and strategic stockholding obligations in conjunction with changes in the Gas Security of Supply legislation.¹

LNG and Demand Side Response

LNG Terminal Operators and end user customers who are able to interrupt or vary their gas demand within day provide a significant source of untapped flexibility in the Italian gas market, which could be used to optimise supply and demand in an economic and efficient manner. As such they should not be prevented from offering gas to the TSO in the any new balancing regime and should be encouraged, through streamlined operational arrangements, to bring the benefits of this flexibility to the PSV.

Nomination and Re-Nomination Timescales

The ability of suppliers and traders to adjust their supply to reflect changes in demand ahead of and during the gas day, and to exploit opportunities to trade at the PSV, is currently severely restricted by the premature nomination deadline and the inability to make renominations at cross-border interconnection points, LNG entry points, storage.

To increase flexibility for parties to balance their positions in a market based balancing regime the AEEG should consider on the development path of a target model:

- requiring the TSO to push back the initial nomination deadline for intakes and offtakes in the national network to 14:00 D-1;
- requiring the TSO to introduce standard lead times for input/output renominations within day;
- as an interim measure, in order to ensure parties remain in balance throughout the day whilst any new balancing regime becomes established, it is possible to introduce a requirement for physical input/output renominations to be balanced with equal and opposite physical output/input renominations. Such an interim measure would be expected to be rescinded once all parties had become familiar and comfortable with the new balancing arrangements (e.g. within one or two years).

¹ Directive 2004/67/EC

Allocation

The current balancing regime, where shippers' positions are *physically* determined by metering of final customers and they do not know with certainty what their imbalance position is until approximately 3 months after the gas day, is inefficient and untenable in a market based balancing regime.

EFET believes it is important that AEEG's efforts should be focused on:

- requiring the TSO and DSOs associations to work collaboratively to develop a series of dynamic standard annual load profiles for specified types of non daily metered customer throughout Italy;
- ensuring the TSO is appointed to perform the allocation activity in a harmonised way and TSO and DSOs are provided with sufficient funding to undertake this work and sufficient incentive to provide any necessary system improvements that may be required, recognising that efficiently incurred costs in this area will be more than outweighed by benefits arising from greater liquidity and market efficiency;
- introducing a "one-to-one" relationship between delivery points in the DSO grid and shippers, which is essential in a target model. However, taking into consideration that this involves a structural change in commercial relationships, interim measures have to be carefully crafted in order to limit the impact on current contractual relationships. A framework where resellers/retailers are required to appoint only one shipper-balancing responsible for each relevant area (city gate or larger) could be such an interim measure;
- ensuring that any changes to input/output flows and imbalances that may be required after the close out date as a result of meter reads/errors are managed through a non discriminatory reconciliation process, and settled at a neutral market related price and without "physical" impact on shippers.

Transparency of Imbalance and Flows

Price discovery and transparency of underlying supply and demand fundamentals underpin traded markets and provide signals for long term investment.

Much of the data relating to supply and demand fundamentals is covered by the Regulation in the 3rd Energy Package, which becomes effective on 3rd March 2011. It will be important for the AEEG to ensure that the TSO complies with this fully and provides such data in a timely and user friendly manner.

In order for shippers to respond in a rational economic manner to the financial incentives created by a market based balancing regime they need to have full visibility of their own imbalance position, and of the system as a whole, along with the residual balancing actions taken by the TSO and the cash-out prices derived from such actions.

The measures described above to address the current deficiencies in the allocation process, along with the intra day data feeds from the telemetry installed at import pipelines, storage facilities, LNG facilities and most daily metered customers (such as gas fired power stations), should mean that the TSO captures all the data necessary to be able to provide shippers with accurate within day estimates of their imbalances.

In conjunction with the work going on to improve the allocation process the AEEG should:

- require the TSO to develop an efficient mechanism for using this data to provide shippers with regular updates on their imbalance position within day. Such updates will initially be based on existing data feeds and allocation and demand estimation processes. However, the implementation of the new dynamic standard load profiles is a prerequisite to assign the full responsibility of imbalances to shippers;
- ensure that GME's gas exchange publishes details of all bilateral trading activity and residual balancing activity on an anonymous basis as it occurs. The system should also be able to calculate and publish cash out prices in real time based on such activity.

Market Based Balancing Regime

EFET believes that market based balancing is fundamental to generating greater competition and liquidity in the Italian gas market. However, market based balancing will fail to achieve these benefits unless accompanied by the changes described above, and so it cannot be considered or implemented in isolation.

EFET believes that market participants should be primarily responsible for balancing the system and that the TSO's role should only be residual in nature. To the extent that the aggregated imbalance position of all shippers throughout the day threatens to put the system outside of its safe operating parameters, the TSO should buy and sell gas in traded markets to restore a system balance. TSO's interventions in traded markets to residually balance the system should be fully transparent. Additionally, to alleviate any fears of unfair competition arising, GME can be interposed between the TSO and market participants.

Shippers should be financially incentivised to balance the system through cash out prices derived from the marginal cost of any residual balancing actions taken by the TSO. The TSO should be financially neutral to the costs and revenues arising from its residual balancing actions and these, along with the costs/revenues resulting from cashing out the shippers end of day imbalance positions, should be smeared back to shippers through a non-discriminatory neutrality mechanism.

EFET recognises that moving from a regime where the TSO has primary responsibility for balancing the system, and direct control over the flexibility required to do so, to one where it has only a residual role may need to be implemented gradually, with interim checks and balances being adopted at different points on the way. This gives the TSO time to get familiar and comfortable with safely operating the system whilst not exerting direct control over the flexibility inherent in the system, which instead is made available to market participants. It also gives shippers time to get familiar and comfortable in managing their cash out risk and exploiting the rewards available to them from having greater access to flexibility.

EFET believes the AEEG should, in conjunction with market participants, work to develop a framework:

- introducing a full residual balancing regime based on the intraday gas market under development by GME. Such an exchange would be the principal mechanism through which the TSO buys and sells gas to residually balance

the system and through which traders and shippers buy and sell gas bilaterally;

- developing the gas exchange to allow shippers to post bids and offers for physical gas which is bought or sold at an entry/exit point. Renomination rights are fundamental to allowing shippers to increase/decrease; intakes/offtakes. This would allow the TSO to buy/sell gas to residually balance the system in a manner that allows it to monitor the physical flow rate change behind the trade, although the TSO should be encouraged over time to trade at the PSV to residually balance the system as it incentivises the use of the most efficient resources to balance the system;
- developing the gas exchange to allow for both continuous day ahead and within day trading as this would benefit liquidity. Initially the TSO should be allowed to undertake residual balancing actions day ahead and within day, but over time it should be encouraged to only buy and sell gas within day;
- restricting the TSOs right to reserve storage capacity as this distorts market outcomes;
- developing appropriate tolerances for parties supplying different types of end users within which cash out imbalances will be settled at neutral (e.g. average) prices and above which marginal cash out prices shall apply. Over time these tolerances should be reduced as the parties become familiar and comfortable operating under the new residual balancing regime.

Transparency and reporting

Reputable market information providers² now regularly publish information on prices and transactions, with assessments of most relevant contracts traded at the PSV. Moreover the establishment of a gas exchange will support transparency and price discovery. Thus we suggest AEEG should now stop the monthly reporting requirement introduced with Delibera ARG/gas 161/09 which asks shippers and traders to provide details on each single transaction registered at PSV as this way of collecting information is indeed burdensome and not efficient. EFET supports transparency and recommends AEEG implement a system of monitoring activity on standard products based on information collected through reputable trade publications and the GME platform. In due course we would expect Multi Trading Facilities (MTFs) and Brokers platforms to also provide trade data which would be available to NRAs through an EU wide energy trade data repository.

² ICIS Heren publish daily PSV price assessments for day-ahead, weekend, month-ahead, second month-ahead, front season and front gas year, along with details of recorded transactions. Alba Soluzioni publish daily PSV price assessments for 15 separate periods up to two years out, along with details of recorded transactions. Platt's publish daily PSV price assessments for day-ahead and front month

SPECIFIC COMMENTS to the CONSULTATION PAPER

Storage capacity allocation (5)

In principle EFET agrees that on a technical point of view the balancing reform proposed can be started whilst preserving the current regulation on storage capacity allocation. However EFET believes the effectiveness of the outcome would be affected if the current regulation on storage capacity allocation is preserved since this represents a significant barrier to entry for new market players. Priority storage access for users serving households favours vertical integration since it compresses wholesale and retail markets.

The current regulation also adds complexity when defining the “right” amount of storage capacity needed by each customer, complicates the switching procedure in retail markets and introduces regulatory uncertainty in case of monitoring of storage capacity use in respect of allocation purpose.

The Legislative Decree n.130/2010 approved last August could in principle provide access to new built storage capacities to industrial end users and power producers. Nevertheless details are not yet defined and it is not clear if the issue highlighted above will be solved until when new capacity starts functioning. Nevertheless in EFET point of view the measure does not introduce opportunities for *all* traders, wholesalers and potential new entrants and finally the additional capacity will likely be available in the next 5 years, while EFET suggests that a fully effective market design would be implemented in the shortest possible

Whilst governmental/regulatory intervention on Capacity Allocation Mechanisms (CAM) and Congestion Management Procedures (CMP) for storage might be not part of the first implementation phase of the new balancing regime, we stress that this shall be part of a transparent roadmap consistent with the development of the Guidelines of Good Practice developed by ERGEG and the related Framework Guidelines³.

Basic principles

Balancing period and single balancing point

EFET supports a daily balancing regime. Different balancing periods are possible, but the crucial point is the consistency with the ability of network users to balance their portfolio in terms of information provision, renomination lead times and access to flexibility.

The proposal to have a single balancing point in Italy is a step forward compared with many others European countries where congestion or different control areas restrict competition development. In case congestion emerges when implementing a market based regime, EFET recommends maintaining a single balancing area but promoting quick interventions to eliminate congestion through investments in interconnections, as suggested for other markets.

Balancing responsibility

EFET agrees that the TSO must be responsible to maintain the *physical* balancing of the system within a safe area. Nevertheless we believe it is important that – consistently with the development of the framework guidelines at EU level – the primary responsibility for balancing should be assigned to shippers. This means that

³ ERGEG published on 28 July 2010 an “Assessment of CAM and CMP for effective access to gas storage”. Deadline of the consultation is the 9th October.

shippers are *commercially* responsible for the balancing of the system. The TSO plays a role of residual balancer. This implies that the TSO intervenes in the market only when the trading activity within the shipper community would not ensure the balancing of the system and additional resources would be needed.

Within this configuration, in case congestions would emerge, it should also be possible for the TSO to undertake locational trades (i.e. gas injected/ejected from specific points/areas in the network). This option should be valid at least in a transitional phase until any congestion is effectively removed. This should also reduce, or even remove, the need for storage capacity currently reserved in favour of the TSO to perform the “balancing service”⁴. In a market based balancing regime storage capacity reservation for the TSO would distort the flexibility resources market and thus market outcomes.

Market Based balancing Regime

The introduction of a market based regime to provide balancing resources is a key element for the development of the Italian gas market, for the integration with EU markets and to promote Italy as one of the most important European gas hubs.

AEEG proposes that the TSO selects balancing resources through a merit order day ahead and/or within day. This could imply that the TSO provides balancing resources through an auction acting as the auctioneer. This seems to be inconsistent with other parts of the consultation paper as it suggests a complete separation between a balancing market and traded markets, which EFET does not support.

EFET suggests that the TSO acts as a residual balancer acquiring its residual balancing needs day ahead (at least initially) and within day, on a continuously traded market.

EFET believes that limiting the balancing market to one (or more) auction(s) would create inefficiencies and would hamper the possibilities for traders to trade within day between each other, especially in the context of market arrangements proposed regarding mandatory offers (see below).

EFET believes that using an auction mechanism for balancing markets is unusual in gas markets. However, if this is the market mechanism chosen in the first phase, EFET strongly recommends restricting it to the day-ahead auctions with a continuous intraday market being used to rectify short term demand and supply variations within day.⁵

Offers

Within the auction mechanism, AEEG proposes that non-nominated storage capacity should be *mandatory* offered in the balancing market without any price constraint.

⁴ Currently part of the injection and withdrawal storage capacity is reserved for the TSO to perform the Balancing service activity (please see http://www.stogit.it/wps/wcm/connect/stogit/Stogit_EN/Home/Business+area/Storage+capacity/Confer+red+capacities/?WCM_Page.ResetAll=TRUE concerning allocation for the TY 2010-2011)

⁵ In order to allow a learning process, it would be possible to introduce for a transitional period a similar framework to the “*offerte integrative*” system, applied in the power sector when the exchange was established. This framework provides the possibility for the TSO to ask for “additional demand bids/offers” before market results are published in order to minimize balancing needs within day. The TSO might make use of GME in order to ensure confidentiality.

EFET understands that a learning period would be necessary for market players, however we believe that this would add complexity and practically hinder the possibility for traders to balance their position within day without incurring in penalties. EFET believes that a system where the TSO acts as a residual balancer if the market does not offer enough resources for balancing and an appropriate transparency framework exists within day would minimise balancing costs and increase the overall market liquidity.

EFET believes that rather than an obligation to offer available storage capacity it is more efficient to introduce a stronger framework on information provision (from the TSO to the shipper community) consistent with the balancing period and renomination rights within day for storage capacity and other flexibility resources. The point of information provision is crucial in the development of balancing markets in the context of the draft ERGEG framework guidelines on gas balancing .

EFET suggests that in a transitional phase renomination rights are introduced for storage capacity only⁶. However it should be ensured that developments along these lines – consistent with the EU framework – are not hampered.

EFET supports that all offers are considered undifferentiated in respect to the single balancing point. Of course, in a mid-term configuration, renomination rights within day are crucial for all flexibility resources i.e. all entry point to the national transportation network (x-border points, storage, LNG terminals).

Benefits (16)

EFET shares the view that a market based mechanism would increase the efficiency in the selection process of balancing resources. However, until CAM/CMP rules on storage capacity are improved, EFET believes that the market will not be able to benefit from new entrants in the wholesale market and discrimination between different kinds of market participants will remain.

Shippers' position

AEEG proposes that shippers' storage positions would be defined "*a few days after the gas day, when metering from storage fields is available*". This involves the TSO accepting offers when the market session is closed, on the basis of actual flows.

EFET believes that this would add uncertainty and this would be unacceptable in a competitive environment i.e. shippers would not be able to take trade imbalances retrospectively if ex-post acceptance of storage balancing offers is implemented. This would deliver very limited benefits compared with the current regime and it would not go in the direction of harmonisation of balancing arrangements at European level, where physical positions are closed at the end of gas day – unless relevant malfunctions are detected –and all reconciliations are exclusively financially settled. Differently, EFET could support the possibility to allow ex post trading of imbalances; this should be limited for an initial learning period.

EFET emphasizes that it is crucial that the engagement of the TSO in traded markets, directly or through GME, does not place extra uncertainty on market players.

Simplified balancing regime

⁶ As an interim measure renomination rights for storage capacity could be limited to a specific time window, according to the within day traded market (i.e. from 9am to 5pm)

In order to minimize the initial impact of the upcoming reform, AEEG proposes that in a first phase balancing resources would be limited to offers regarding storage capacity.

EFET understands the need for gradual reform, but is keen to remove barriers for new entrants and secure benefits from more efficient gas and power interaction and improved integration with neighbour countries. Thus EFET highlights the need to remove as soon as possible obstacles to allow renomination rights for other entry points (LNG, x-border, and demand-side).

Additional concerns arise regarding the simplified regime in terms of number of competitors in the balancing market, number of different sources of flexibility and limited harmonization and integration with neighbour markets.

Nevertheless EFET could agree on a simplified balancing model provided this was set within the framework of a transparent implementation roadmap for a target model. The main contents of this simplified model should be identified and shared between stakeholders and it is crucial that the roadmap leads to a regime consistent with the European context in a limited timeframe.

In order to support AEEG in identifying the contents of a simplified model consistent with the target model mentioned above, please find attached the EFET position paper *Framework Guidelines on Balancing*.

EU context and framework guidelines

EFET welcomes AEEG references to considering balancing in the European context. EFET underlines that within the development of the draft ERGEG framework guidelines great importance is reserved to the provision of flows information consistent with the balancing regime. However EFET notes that the consultation paper does not include proposals on information provision and harmonisation and underlines the need for a deep analysis, in particular taking into consideration the Regulation 715/2009 and the development of framework guidelines concerning CAM/CMP on transport capacity.

Administrative instruments

EFET welcomes AEEG examination of additional instruments that could be incompatible with a market framework. EFET believes that back up services might be useful to manage emergency situations; however these measures should be compatible with market based mechanisms.

EFET wants to emphasize that this point is crucial to increase trust in market mechanisms. The threat of administrative interventions undermines the overall credibility of market mechanisms with detrimental effects on competition. Price limits or obligation to maximise cross-border flows would be detrimental of market development and would reduce the overall credibility of the market.

Nomination timescales

EFET believes that initial nomination deadlines can be easily moved closer to the gas day. However in a market based regime renomination rights are much more relevant

in order to maximise flexibility resources available for market participants and provide balancing energy in the most efficient way.

Settlement – Balancing Session and simplified allocation procedure

EFET agrees with the issues highlighted relating to concerns about the current settlement process and additionally highlights that the fragmentation in DSOs market gives room for discrimination and very different allocation practices, which have a material impact on wholesale market players.

EFET welcomes a deeper consultation and reform of standard load profiling. EFET believes that this is a crucial point to ensure the overall consistency of the balancing regime and to minimize the cost of information provision in real time.

In other systems e.g. Germany, the residual withdrawal profile (i.e. sum of withdrawals made by non daily metered customers) is allocated *day ahead* on the basis of a simplified forecast model (d-2 actual flows) and split between shippers on the basis of predefined rules.

Given the relevant issues related to the current standard load profiles system, an impact assessment is necessary to assess if such a simplification can be acceptable while a dynamic SLP is developed. In particular it has to be ensured that the reconciliation process is performed in a transparent manner with neutral prices.

EFET understands that the introduction of a “one-to-one” relationship between a delivery point and a balancing responsible shipper is crucial to facilitate information exchanges. However reform will be a gradual process and a simplified allocation procedure (day-ahead allocation for non-daily metered customers) could remove major obstacles, albeit possible impacts should be carefully considered.

Single commercial counterparty for balancing and transport

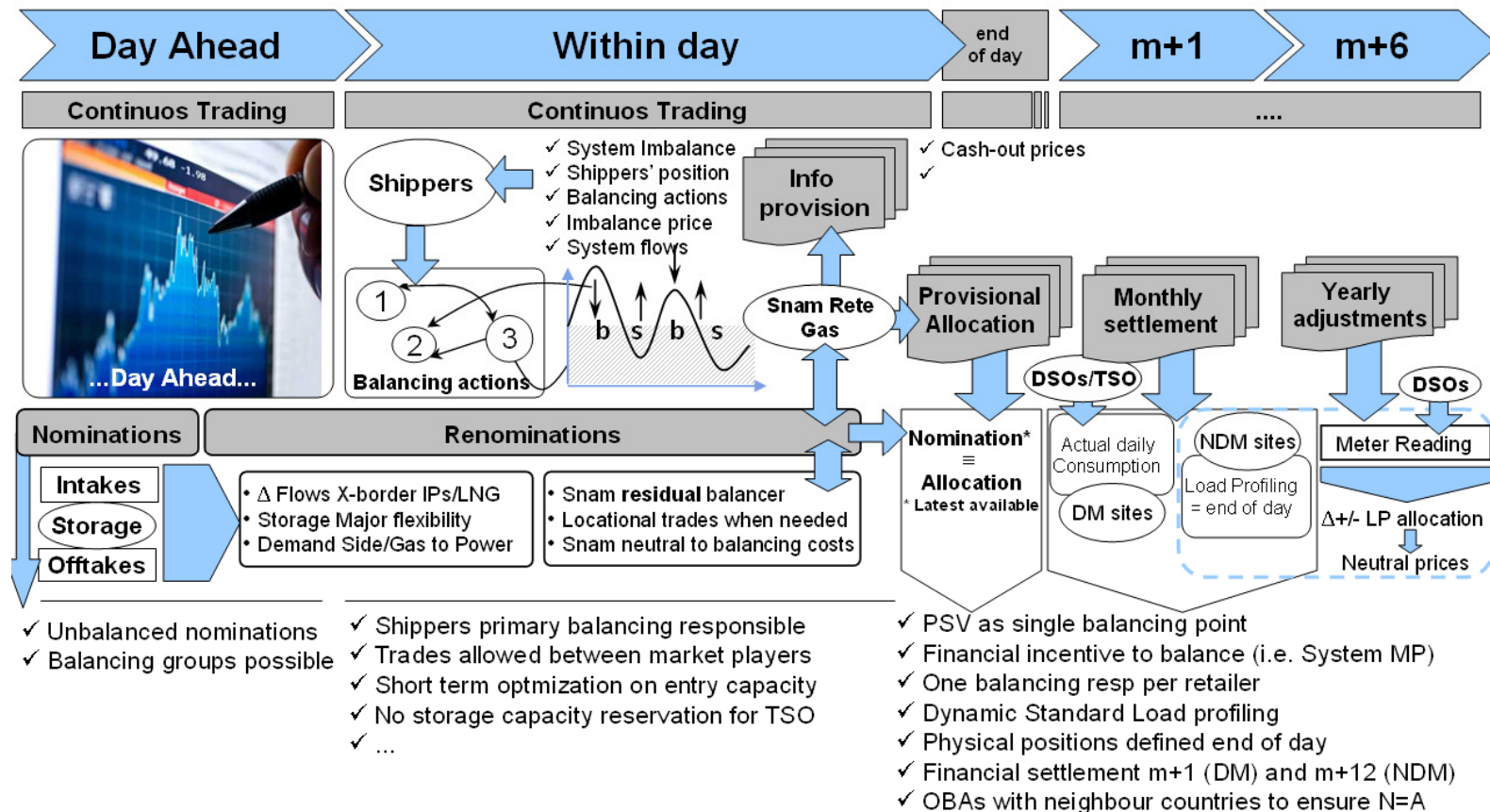
EFET believes that in order to remove discrimination in the current gas allocation process performed based on data computed by DSOs it is crucial having a single standard process to determine a shipper’s physical and commercial balancing position. This should be ensured by a clear assignment of responsibilities between the TSO and DSOs.

In the next page you will find a high level diagram of the target model that EFET believes can be achieved by the Italian gas market.

EFET would welcome the possibility of discussing the contents of the proposed target model with you and to identify a possible roadmap towards a fully market based balancing regime, harmonised with best practices at European level in order to foster market integration.

EFET would like to emphasize finally that is crucial that a reference framework and a roadmap is defined in a timely and effectively manner in order to give all the stakeholders the necessary vision on the upcoming changes

Market Based balancing regime - High Level Model



Corollary

- Market based CAM/CMP for storage capacity
- Harmonisation @regional and EU (gas day, line pack calculation, balancing regime, gas allocation meth)