

CRE consultation on the gas storage capacity auction design



EFET comments – 8 July 2016

The European Federation of Energy Traders (EFET) thanks CRE for the opportunity to react to its proposals on the design of an auction mechanism in relation to the reform of the gas storage obligation in France.

We welcome the statements made by CRE in support of the reform of the existing storage obligation, and its engagement in discussions on the design of the auction mechanism. We refer to our comments of November 2015 on the DGEC draft ordinance and our feedback on the CRE workshop of 15 March, both annexed to this document, for more background on the EFET position regarding the reform of access to gas storage and the design of the auction mechanism.

We agree with some of the regulator's concerns with regard to the implementation of the future ordinance, and share the belief that CRE should be the agent determining the reserve price for the auctioning mechanism, based on general principles developed in the ordinance, as well as the authorised revenue of the storage operators.

EFET reiterates that the reserve price should be set at a sufficiently low level to guarantee a high level of storage bookings and make any safety net or mandatory bookings redundant.

Question 1:

EFET agrees with the general remarks outlined in the document.

EFET stresses the importance of setting the reserve price at a level that is prone to incentivise shippers to participate in the auction and use storage capacity on the basis of its extrinsic and intrinsic value. If the reserve price for storage products is in the money, any shippers with an interest in storage for the supply of a customer portfolio or for pure trading activities will enter in the auctions and bid up to the value they are willing to pay for such storage products.

The revenues of the storage operators can be maximised only by attracting the highest possible volumes. In order to do so, a competitive reserve price linked to the summer-winter spreads needs to be set, taking into account all related costs and risk discounts, such as those linked to transportation.

Question 2:

EFET generally supports sequential auctions for storage capacity products to ensure that the offered products and timing matches market participants' needs. The commercialisation period from 1 November till 31 March is in part satisfying: before the end of December, a minimum of 25% of the available capacities should be made available by the storage operators. However, we believe that the auction period could be extended until even after the start of the injection season (end of April at least): indeed, multiple auctions taking place over the whole winter period, with the potential activation of the safety net mechanism taking place even after the beginning of the injection season, would give more chance to the auctions and allow shippers to adapt their bookings to the evolution of their portfolio.

The multiple auctions should be cleared on a daily / within day basis to ensure swift convergence of the clearing price in each session and avoid collateral risks related to market price volatility.

Question 3:

EFET is not in a position to recommend a specific number of products to be commercialised by the storage operators. We see merits to storage system operators (SSOs) developing various storage products to ensure that storage in their facilities is attractive enough. We would however warn the regulator and the SSOs regarding the number and size of the products auctioned, i.e. not to propose too vast a portfolio of products or too large products, which could damage liquidity on the market for each product or their attractiveness for market participants. SSOs should strive to strike an appropriate balance in their product offering after consulting with market participants on which types of products seem most attractive to them.

The CRE proposal to have nine products as a whole seems to be reasonable and should be manageable for market participants.

Question 4:

EFET supports the idea that the SSOs have the possibility to adapt the volume of their products between different auctions (but not between rounds of the same auction). However, SSOs should not be allowed to change the key characteristics of each product or introduce new products in case the safety net is activated, and should ensure that a minimum level of capacity is offered in each auction.

Question 5:

EFET is amenable to the idea that a minimum of 90% of the commercialised products (in terms of volumes) has to be pre-defined and that the SSOs would be free to define bespoke products for the remaining share.

Question 6:

EFET supports the principle according to which the SSOs can freely market their products after the required level of storage capacity is reached. The regulator should be attentive to the coherence of the auction specifications before and after the minimum level of storage bookings is reached in order to avoid significant discrepancies between the auctions, e.g. with regard to the level at which the reserve price is set.

Questions 7 and 8:

EFET supports both approaches. First and in case the required level of storage capacity is not reached by 31 March, the SSOs should continue to market their products through auctions even if the process to oblige shippers to acquire storage is launched. Further clarification is nonetheless needed with regard to the procedure when the safety net has been activated and post-31 March auctions enable the minimum storage bookings level to be reached: in this case, the safety and all relating rights and obligations should be suspended.

Second, and in case the required level of storage capacity is reached prior to 31 March, the SSOs should be free to market their available products.

We also support the requirement according to which SSOs should provide information on the characteristics of the commercialised products (including the auctioned volumes) ten days before the auction.

Question 9:

As mentioned in our recommendations following the CRE workshop of 15 March, EFET supports the multiannual N+1, N+2, N+3 approach and is also in favour of multi-annual products within a limit of approximately 30% for the second and third years. Multiannual products should be offered at the beginning of the campaign and, in case of partial allocation, the remaining capacity should be offered on a yearly basis.

Questions 10, 11, and 12:

EFET considers that a sequential approach (by batch) would allow shippers to efficiently adapt their bidding strategy. The same goes for the proposal to hold sequential auctions per SSO, bearing in mind that this system should not negatively affect competition between SSOs.

Questions 13, 14 and 15:

We recommend the organisation of ascending auctions, with a pay-as-cleared pricing mechanism. The duration of an auction should be maximum one day and the outcome should be a fixed (and not a spread-indexed) price.

While we believe that more and more auctions are organised in this manner in Europe and that market participants are gradually getting used to such ascending, pay-as-cleared auctions, we do realise that this change may entail a certain level of complexity for some parties. Therefore, we insist on the need to define clear and simple rules in order to ensure a short timing between the beginning and the end of each auction and avoid any discrepancies linked to important market evolutions.

In the medium term, CRE could consider a more elaborate auctioning system with multiple rounds within each auction, on the model of the framework in place in the Netherlands. Provided that these auctioning rounds would be organised within one day, it could improve competition in the market while guaranteeing higher revenues for SSOs, with the ultimate goal to reduce end-consumers' contribution to the regulated SSO compensation mechanism.

Question 16:

We believe that the reserve price and the formula – in a way that can be recalculated by market participants – should be published a few days before the auction.

Should this option be excluded by CRE, we insist that at the very least the formula and all relevant elements to determine the reserve price be published a few days before the auction.

To the avoidance of doubt regarding the effect of such transparency on the outcome of the auctions, we attract CRE's attention to the Italian experience in terms of transparency of the reserve price formula: the publication of the reserve price formula in the new storage capacity auction system in Italy does not necessarily lead market participants to bid close to the reserve price: market participants continue to bid around the spread.

Question 17:

No further comments.

Annexes:

- *Annex 1:* EFET reaction following the CRE workshop on the review of the gas storage obligation – 29 April 2016
- *Annex 2:* EFET comments on the DGEC proposal of an Ordinance on the reform of the storage obligation - 20 November 2015

ANNEX 1:

**EFET reaction following the CRE workshop on the review of
the gas storage obligation – 29 April 2016**

The European Federation of Energy Traders (EFET) thanks CRE for the organisation of the workshop on 15 March 2016 on the review of the gas storage obligation, and more particularly on the auctioning of storage capacity.

We welcome the statements made by CRE in support of the reform of the existing storage obligation. We refer to our comments of November 2015 on the DGEC draft ordinance, annexed to this document, for more background on the EFET position regarding the reform of access to gas storage in France. We also agree with some of the regulator's concerns with regard to the implementation of the future ordinance, and share the idea that CRE should be the agent determining the reserve price for the auctioning mechanism, based on general principles developed in the ordinance.

In more detail, the EFET position on the five main discussion points at the CRE workshop of 15 March is as follows:

1. Auctioned product(s)

The EFET view with regard to the number of products is not precisely set. We see merits to storage operators developing various storage products to ensure that storage in their facilities is attractive enough. We would however warn the regulator and the storage operators regarding the number and size of the products auctioned, i.e. not to propose too vast a portfolio of products or too large products, which could damage liquidity on the market for each product or their attractiveness for market participants. Storage operators should strive to strike an appropriate balance in their product offering after consulting with market participants on which types of products seem most attractive to them.

We are in favour of storage operators proposing multi-annual products. Capacity in the range of about 30% could be allocated via such products.

2. Trading timeline

We believe that each auction could be organised in multiple rounds, to be cleared on a daily / within day basis to ensure swift convergence of the clearing price in each round and avoid collateral risks related to market price volatility. Multiple rounds could take place over the whole winter period, with the potential activation of the safety net mechanism taking place even after the beginning of the injection season (e.g. in May), to give more chance to the auctions and to allow shippers to adapt their bookings to the evolution of their portfolio.

Allocating storage capacity as close to its use as possible is important to make storage products attractive to market participants and eventually ensuring a higher level of gas in store, even once entered into the summer period. Moreover, such a timeline would be consistent with the current regulatory milestones related to the storage obligation controls assigned to shippers (*cf. ex-ante* request as of May 1st, *ex-post* request as of Dec 1st).

3. Setup of the auctions

EFET considers that the full capacity should be commercialised as of the first auction for the relevant delivery year. As mentioned above, multiple auctions should be organised should the allocated capacity in the first auction not correspond to the minimum storage level required by legislation. Storage operators should also be free to continue auctioning storage capacity beyond the minimum storage levels as defined in legislation.

We favour sequential auctions for Storengy and TIGF to ensure that the offered capacity products and timing matches market participants' needs.

All necessary information should be published, ahead of each auction date, to enable market participants to optimise their bidding strategy. This includes the volume of capacity auctioned by the storage operators.

We recommend the organisation of ascending auctions, with a pay-as-cleared pricing mechanism. While we believe that more and more auctions are organised in this manner in Europe, we do realise that this change may entail a certain level of complexity. Therefore, we insist on the need to define clear and simple rules in order to ensure a short timing between the beginning and the end of each auction and avoid any discrepancies linked to important market evolutions.

Finally, we are also in favour of an indexation of demand on relevant spreads (TTF and PEG Nord).

4. Reserve price determination methodology

Determining the right reserve price will be key to the success of the auctioning mechanism. We agree with CRE that this responsibility should lie in the ends of the regulator, based on general principles developed in the ordinance.

The reserve price setting methodology should take account of market spreads (PEG Nord), but also of costs and risk discounts.

We believe that the reserve price – or at the very least the formula – should be published a few days before the auction. Experience of a similar setup in Italy shows that the publication of the reserve price formula does not necessarily lead market participants to bid close to the reserve price: market participants continue to bid around the spread.

5. Trading platform

We recommend the use of a common platform for capacity products offered by storage facilities in France.

EFET has no particular recommendation with regard to choosing a specific platform. However, we believe that there are a sufficient number of auctioning platforms in France and Europe in various segments of the market, and that we should make use of an existing platform to avoid unnecessary development costs on the side of storage operators and reduce administrative costs on the side of market participants.

ANNEX 2:

EFET comments on the DGEC proposal of an Ordinance on the reform of the storage obligation - 20 November 2015

EFET welcomes the opportunity offered to market participants to comment on the draft legislation reforming third party access to underground gas storage capacity in France.

However, we regret the very short timeline provided for submitting comments on the draft legislation, as well as the absence of the accompanying regulatory documentation (including in English), preventing us from forming an educated opinion on the overall framework to be introduced.

We welcome DGEC's decision to introduce the "auction + compensation" mechanism which EFET supported in its answer to the public consultation rolled out in April 2015. EFET is committed to the creation of an attractive and competitive European gas market. To complete the construction of this market, it is necessary to establish coherent and market-based rules in all Member States as soon as possible. The current state of the French rules for access to underground storage significantly differs from European standards and is fully based on obligations rather than a market mechanism. The proposed mechanism, if well designed, can deliver the results EFET is seeking.

However, EFET believes that the current draft stands mid-way between the implementation of a workable market-based mechanism and the current system based on a storage obligation. This situation will undoubtedly lead to a less efficient outcome. As a consequence, EFET would recommend the Ministry to review the draft to propose a robust market-based mechanism delivering the highest level of efficient storage capacity reservation.

1. On the determination of the need for storage capacity in the PPE

Whilst EFET agrees the PPE seems to be the appropriate vehicle to give a forward view on the need for storage capacity in France, there seems to be some inconsistencies between the theoretical perimeter of the storage capacity currently in operation and the scope considered as the cost base of the storage operator. This needs to be clarified.

Moreover, EFET questions the proposal to include all existing storage facilities into the perimeter of regulated assets until the end of the second PPE period (i.e. 2023) without a thorough cost-benefit analysis. We believe a transparent process aimed at identifying the amount of storage capacity needed to underpin security of supply should take place well in advance of 2023.

2. The definition of a minimum annual stock necessary to ensure peak demand

Whilst EFET does not reject the rationale for this proposal, the legislative treatment as currently foreseen in the draft *Ordonnance* seems insufficient.

Firstly, the “minimum stock” should be the result of a risk assessment for which the methodology and parameters are transparent and subject to a public consultation. It seems that the risk assessment foreseen in the EU regulation on security of supply could be appropriate for this analysis.

Secondly, the *Ordonnance* should include a deadline for the publication of this “minimum stock” given that this value will have implications on the commercial strategies implemented by shippers to book storage capacity. To this end, we propose to publish this “minimum stock” at the latest on 31 December each year.

Thirdly, this “minimum stock” must be accompanied by a reference date at which this volume must be achieved. In our opinion, this date should not be before 1 November, the notional start of the withdrawal season.

3. The marketing of underground storage capacity through auctions

EFET welcomes the introduction of auctions as the only allocation process for storage capacity in France. This will bring the commercialisation rules in France in line with European best practice.

However, a number of principles must be kept in mind when developing the legislative framework surrounding the parameters of these auctions.

EFET stresses the importance of setting the reserve price at a level sufficient to incentivise shippers to participate in the auction and use storage capacity on the basis of its extrinsic and intrinsic value. We believe such a principle should be at the foundations of the new regulatory framework for storage and enshrined in the *Ordonnance*.

If the reserve price for storage products is in the money, any shippers with an interest in storage for the supply of a customer portfolio or for pure trading activities will enter in the auctions and bid up to the value they are willing to pay for such storage products. For simplicity reasons, we suggest setting the reserve price at 0€/MWh or at the marginal cost of running the storage facility in order to maximise storage capacity sales in most foreseeable cases.

Alternatively, the storage auctions reserve price should be based on live market prices. A coherent reserve price could either be determined very close to the day of the auction to make sure the reserve price is commercially attractive at the time of the auction or be based on quoted market price prevailing on future specified dates. The provision envisaged in the *Ordonnance* seems to set these reserve prices long before the auctions actually take place which could result in auctions failing to meet

market participant's expectations and storage capacity remaining unsold, if not designed carefully.

As a consequence, EFET recommends amending recital II of Article 5 to account for this fundamental need to have reserve prices in line with live market prices. In particular, CRE should not submit prices for decision by the Minister but simply come up with a formula which, when applied, will give the reserve price applicable in each auction based on prevailing market prices. In terms of auction mechanism, EFET believes that the most fundamental point is to ensure that storage sales are maximised and a fair price is determined for the considered storage product. Ascending price auctions, already used for cross-border capacity, is one possible way of meeting this criterion.

It is also worth noting that transmission tariffs applied at storage entry and exit points will also affect the extent to which shippers consider storage to be a commercially attractive.

4. Regulation of revenues for storage operators and introduction of a compensation mechanism

EFET welcomes the reference to the “efficient operator” as the key concept for regulating French storage operators.

However, EFET underlines the need to introduce financial incentives in this regulation framework. Financial incentives have effectively improved the quality of service provided by TSOs and DSOs. We expect similar outcomes for storage operators. On the contrary, the absence of financial incentives usually leads to slower efficiency improvements, if any.

With regard to the compensation, EFET believes that some principles must be kept in mind:

- **The compensation should only apply to domestic exit points** and not to cross-border entry and exit points. French gas consumers benefit from the security of supply standards and should bear the costs. An increase in cross-border costs would disincentivise shippers to ship gas to France;
- If integrated into the transmission exit tariffs to regional exit zones, the compensation should be subject to a specific regulatory treatment strictly separated from the normal transmission tariffs;
- The calculation of the compensation should be completely transparent and based on the characteristics of the customers benefitting from the security of supply standards.

5. Last resort obligation in case of insufficient reservations during auctions

EFET does not support the creation of a last resort obligation. In a well-designed mechanism, all available and necessary capacity for shippers to ensure security of supply criteria shall be booked and no last resort mechanism shall be needed.

As highlighted at point 3, the auction reserve price should be determined with the objective of attracting as many market participants as possible in the auction process. In case an auction does not lead to the desired level of reservation, another auction should be launched with a lower reserve price in order to meet market expectations.

In case a last resort obligation is deemed necessary, the decision to trigger it should be made later than 1 March as envisaged in the *Ordonnance* so as to leave time for remarketing unbooked capacity. EFET believes that 1 May is an appropriate deadline for such a mechanism.

Finally, EFET questions whether a penalty price of 130% of the reserve price of the considered storage product is justified in the case of suppliers with storage booking deficits. Some shippers may already have an abundance of flexibility within their portfolios and booking late storage capacity involves increased costs to meet technical requirements as well as lower optimisation potential, thus already negatively impacting non-compliant shippers.