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Per E-mail: Monika.zsigri@ec.europa.eu

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Comment on the EC's Follow-up study to the LNG and storage strategy, published September 2017

We would like to take the opportunity to answer the two questions on storage provided with the agenda of the Stakeholder Workshop on 27th September.

Ad Question 1

The REKK report recognizes that gas storage provides flexibility, network support and contributes to security of supply, but does not mention that the full benefit to society of gas storages is not being captured by the revenues of a SSO. This suggests that the market might lead to substantial underutilization of gas storages in the modelling results. Even the extrinsic value the market is willing to pay, as mentioned in the report, is not included in the modelled results. The modelled storage usage does not give realistic insights to base further decisions on.

Storage facilities provide value to gas customers in four key ways:

- Seasonality – storing gas in summer (lower demand periods) and withdrawing gas in winter (higher demand periods).
- Flexibility – supporting day to day and week to week variations in gas demand away from the average demand that might be expected.
- Insurance – avoiding risks to security of supply and extreme prices driven by factors such as weather, asset failures, and political events.
- System value – reducing the need for extra-large networks, particularly to deliver gas behind pipeline bottlenecks, and aiding pressure and congestion management.

Current market arrangements allow storage to be paid for the value of the seasonality and flexibility that they provide. However, because shippers are insulated from the full costs of loss of supply, storage companies in merchant markets do not receive the full social value of the insurance that they provide, and are not paid for the system value that they bring. Unlike other flexibility services storage offers the advantage of a physical asset located close to demand areas. In fact, storage is a flexibility tool that can be physically guaranteed.

Actual market situation, whereby storage companies can only capture part of the value they bring to the system, will result in the closure of storage and will lead to the reduction in the availability of storage assets (and physical availability of gas where others fail to do so) to be used in different crisis scenarios. We strongly believe that closure of storages will negatively impact the current high level of Security of supply in Europe. Considering the long lead times to rebuild storage facilities, it seems an urgent matter to react and adapt now as a gas storage facility can quickly reach a point of “no return” and be closed down forever. Given the important role that gas storage can play to balance increasing supplies from intermittent renewable energy sources with fluctuating power and heat demand we consider it even more short-sighted to risk premature closure of storages as one of the future key infrastructures to achieve EU’s decarbonization goals.

Ad Question 2

Regarding the need of storage related Security of Supply measures e.g. storage obligations or other forms of safeguarding minimum storage levels we want to provide some relevant facts to be considered.

In the past in Germany but also in most other EU countries with high gas import dependency storages were churned frequently by 2/3 of their available working gas volume on an annual basis depending on yearly demand. This fluctuating seasonal churn depends on normal changing weather conditions and correspondents to the availability of actual import infrastructure.

During frequently occurring cold snaps, storage show a second quality provided to the SOS level in Europe. In high demand situations where peak capacity is needed on very short notice, storage contributes by delivering frequently more than 50% of the daily demand, faster than any LNG cargo can or might reach a terminal. This has been recently recorded in Germany in Jan/Feb 2017 and in other EU-countries. In order to provide such delivery rates out of storage, beneath the annually churned volumes a minimum filling level of $> 1/3$ of the working gas capacity is required, which should only be reduced at the end of the winter season or, if necessary, in a critical supply situation with major failure of the supply chain. Neglecting the last 1/3 of storage capacity and assuming them as “not used” respectively not needed leads to a significant risk not being able to ensure delivery to sensitive (protected as industrial) customers even in normal winter demand situations or with a sudden peak demand.

Under current market regimes storage users have no economical incentive in churning only 2/3 of storage capacities and keeping 1/3 for sufficient delivery rates till end of winter season. This is reflected in decreasing seasonal spreads as an indicator for the price for flexibility the market is willing to pay for.

This fact is recognized by many national SOS regimes with different measures implemented like booking obligation or strategic storage obligations. Other countries like Germany or Austria have taken no measures to set minimum storage levels and leave it up to the market. As markets are well connected and cross border trading shall not be restricted by different regulatory rules on national level we strongly

believe that there should be a level playing field on EU level to safeguard sufficient withdrawal capacity till the end of winter season.

In the REKK proposal suppliers shall receive an incentive to physically meet their supply contracts in all supply scenarios otherwise they will be obliged to pay a firm monetary compensation to its customers (Value of lost Load) in case of a supply cut. The effectiveness of this approach strongly depends on the concrete compensation regimes and whether they are implemented harmonized across markets. But there are also a number of drawbacks associated with the VoLL concept. An extreme financial liability faced by short shippers in a crisis could lead to financial distress and adverse impacts on competition. Market participants cannot accurately determine the probability of a crisis appropriately due to difficulties of assessing low probability events. Another aspect is, that transit volumes might not flow into the affected market if arrangements in other countries take precedent. Different regimes in Europe could lead to free riding effects.

INES takes the position that regulatory measures shall apply when market oriented measures fail. Any approach shall pay attention to the value storages are delivering to the market as e.g. the current not valued system value and the physical insurance value of storages and need to be carefully designed.