

EFET response to ACER Preliminary data report on the Market Correction Mechanism

The European Federation of Energy Traders (EFET¹) has previously expressed concerns that the Market Correction Mechanism introduced in Council Regulation (EU) 2022/2578 carries risks to the efficient functioning of the gas market. These arise not only from what may occur when a Market Correction Event is triggered, but also in terms of how the market may be affected as participants change behaviour to address the potential risks of a correction event whether or not the mechanism is invoked.

The role of ACER, in conjunction with market parties and other stakeholders, will be to help determine what adverse events may arise, what may lead to negative consequences, and what may give rise to the circumstances when these risks are increased. This will be important in determining whether the mechanism should be suspended or deactivated.

EFET is supportive of the main conclusions of the preliminary data report and welcomes the work by ACER, particularly given the short timescales available.

Key messages

- EFET agrees that the low wholesale prices presently observed are a result of supply/demand fundamentals and cannot be attributed to introduction of the MCM.
- The main events that may give rise to the MCM being triggered are likely to be infrastructure outages and congestion in LNG importation and onward transportation. The mechanism was not designed with these in mind and may exacerbate any gas shortages arising. We recommend that ACER additionally captures the frequency of congestion and interruption events.
- The implications of capping the *derivatives* market on the *physical* market for natural gas will be widespread and negative, with some of the consequences probably not yet identified. It is therefore important that we track measures relating to prices, gas flows and market liquidity, and we support the range of measures identified.
- Parties are still analysing the legal text to understand fully its application including, for example, the potential impact on existing contracts of a material change in the calculation of a widely referenced index. Further metrics may arise as worthy of investigation, such as triggering of contractual disputes.

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. We build trust in power and gas markets across Europe, so that they underpin a sustainable and secure energy supply and enable the transition to a carbon neutral economy. EFET currently represents more than 130 energy trading companies, active in over 27 European countries. For more information: www.efet.org.

Questions posed by ACER

1. Are there any potential effects that could be triggered by the MCM, and early warning signs that should be monitored, that have not been identified in this ACER report?
2. Are there any indicators that you consider relevant for assessing the effects of the MCM that have not been discussed in this ACER report?
3. Are there any other points which you consider relevant to improve the ACER report on the effects assessment of the MCM that is due on 1 March 2023?

1. Potential Effects

ACER has recognised the key potential effect that trading of derivatives migrates to venues outside EU or otherwise not covered by the mechanism. This is already borne out by a recent announcement by ICE that they plan to offer TTF futures and options out of London, and the EEX proposal to expand trading on OTF.

We would additionally point out that an inability to hedge may reduce willingness to transact. This applies especially to any period when the mechanism is invoked – when a party may be able to buy physical gas at price above the cap but cannot hedge this in EU. It may also apply to forward transactions for periods when there is a potential for price spikes foreseen: risk managers may be less willing to leave open positions that cannot later be hedged properly or unwound because of low market liquidity after the cap is triggered. We further note that even the unwinding of transactions concluded before 1 February will be difficult, since the related trade will need to constitute an offset or reduction to both sides for the exemption to apply.

Accordingly, liquidity may drop – in terms of transactions undertaken – but the depth of the market (in terms of available bids and offers) may also be thin. This is more difficult to measure as only a limited amount of bids and offers are generally posted at any time. To look at measures on Exchanges or MTFs would not necessarily reveal this as participants will only reveal a proportion of their possible activity at any one time.

Finally, legal analyses of the EFET framework contractual arrangements² thus far cause us to believe that an event of the MCM being triggered will constitute a *Market Disruption Event* for contracts using ICE TTF as the reference price. This will result in a fallback procedure to seek an alternative price reference that could support the settlement process. In other words, all the contracts linked to the capped instruments will be reopened and subject to additional negotiations that will require time and may need intermediation of arbitrators. Ultimately, this will only add to the uncertainty on the market, as parties are no longer sure which contracts remain in force.

Additional effects would relate to margin calls or credit support requirements. We expect these to be carefully monitored by ESMA.

² EFET General Agreements are the industry standards employed throughout Europe for the physical trade of power and natural gas and related derivatives.

1b. Early Warning Signs

On a general note, we appreciate the good and comprehensive overview of the market parameters that will need to be monitored in the coming months.

As ACER identified, one key cause of high prices and of price differentials has been congestion in infrastructure. At times, LNG terminals have been fully utilised and LNG vessels have been on sea for longer as they await importation slots becoming available. This has contributed to a price discount for FOB LNG compared to gas traded at a VTP. Limited transmission capacity between markets has contributed to price differentials between the relevant markets. Work is being undertaken to relieve these constraints. In this context, however, it needs to be emphasised that physical constraints can cause sharp price and spread increases. That physical constraint can also be a consequence of the current geopolitical reality, whereby supply cuts and/or restrictions on the ability to divert cargoes to Europe are driven by political pressures and decisions.

Political considerations aside, infrastructure can still be subject to unforeseen events, landslides, sabotage, equipment outages. As examples, two possible events were foreseen as having the potential to lead to a price differential at TTF of more than €35 at a time when prices are above €180.

- There is a failure at a major Dutch LNG terminal. There may be available cargoes which can no longer unload which place downward pressure on LNG prices, whereas a shortage of gas at TTF may send prices at the hub much higher.
- There is a failure of the Norwegian gas transportation system bringing substantial quantities of pipeline gas into TTF. This would likely trigger a high price response at TTF until LNG imports were maximised and a constraint was reached. The hub price could be expected to be greater than any increase in LNG prices.

Under these circumstances, the MCM could be invoked as a result of an infrastructure failure. This contrasts with the rationale for the MCM, which was considered to address concerns about speculative trading on ICE in August 2022, even though the Dutch AFM reported there was no such behaviour that increased prices. We are concerned that MCM may exacerbate a shortage rather than help to make gas available.

An additional cause of price volatility and price increases that has been of concern to market participants has been the acquisition of large volumes of gas for storage injection that has been carried out on a non-commercial basis, supported by state funds, whether carried out by a regulated entity or by a state-supported market party. There is also a lack of clarity on whether similar arrangements will apply in 2023 and how volumes remaining in storage at the end of the storage year should be treated – whether they might be withdrawn and required to be refilled or they may be left in store. It is also understood that a large proportion of existing volumes held in store have not been hedged. These create uncertainties for market participants which can contribute to enhanced volatility.

ACER may also wish to consider whether cargoes are preferentially being directed to LNG import terminals in UK and Turkey, that would previously have been delivered into EU terminals. Parties may prefer to reduce reporting obligations by constraining delivery to non-EU terminals, and remove the option of delivery into EU.

2. Indicators relevant for assessing the effect

EFET supports ACER's identification of the relevant metrics: activity, transactions, active counterparties, relative volatility, measures of liquidity such as bid-ask spread, changes in measures at EU venues relative to non-EU venues, and in-scope products/venues vs out-of-scope venues/products.

We would further advise ACER to consider looking at the potential consequences of interfering with the price index to the existing contractual arrangements. According to our analyses thus far, triggering the MCM would constitute a disruptive event within the understanding of the EFET framework agreement, as a material change affecting the calculation of a referenced index. This could lead to contracts being reopened or brought into dispute. Although such disputes would not be reportable (especially if both counterparties operate outside EU), ACER should keep watch on reported cases.

We encourage ACER to take into account infrastructure failures and attempts of political interference with the supply chains as potential warning signs that need to be signalled to the European Commission for the MCM to be suspended. We would further recommend that ACER also records market intervention events as a source of volatility.

Additionally, we note that the fact that where market participants historically referenced ICE TTF index for LNG transactions, begin to apply other indices such as PRA price assessments or fixed-price, this will facilitate a valuable warning signal that Europe's main gas index has been adversely affected by the MCM. In particular, if longer-term transactions move away from ICE TTF, it indicates a long-term loss of trust in what was the main European natural gas benchmark.

The incidence of cargoes being preferentially delivered into non-EU terminals may not be directly measurable by ACER in the data disclosed by market participants. Comparison of current activity with historical behaviour adjusted for weather and season may give an indication. Relative movements in load factors at UK and Turkish terminals compared to similar measures in EU could give an indication of this. Vessel-tracking data in the English Channel may also reveal a change in behaviour, though ACER may need access to further experience to interpret such information accurately.

Accordingly, we encourage ACER to make use of the market intelligence offered by e.g. the price reporting agencies or the energy-focused media. While we refrain from pointing to specific sources in this response, we note that the press is frequently the fastest source of information on the important moves on the market.

3. Other points

Quantitative information may not always be available, but trends identified by PRAs or reported in media may give an indication where ACER could look more closely. Similarly, actions by platforms to facilitate trading outside EU (such as the ICE TTF futures product to be offered from UK) or to OTF platforms (EEX), would also indicate an adverse reaction to the Regulation.