



BP Response to
CEER Vision Paper
For a conceptual model for the European gas market
Call for Evidence

Ref: C10-CWG-70-03

BP welcomes the proposal to develop a conceptual model for the European gas market. Our experience is that while network access regimes and local legislation continue to evolve, they frequently do so in divergent ways, perpetuating inconsistencies between neighbouring systems. The creation of high level principles as a common reference point will not only allow changes to be measured in terms of convergence, it may also reduce regulatory uncertainty, when unanticipated changes of direction can undermine longer term commitments.

In addition to answering the specific questions contained in the Call for Evidence, we would make the following general comments:

- The barriers to creating a single European market are not restricted to network access conditions. They include different licensing regimes, availability and comprehensibility of local legislation, and differences in regulatory approach (for example where cross-border investment is necessary). Frequently, these are more serious than minor inconsistencies between network access regimes, which can be accommodated by companies that are active in the market.
- Frequently, changes are required by differing policy objectives, which may themselves relate to individual market circumstances in a member state (levels of local production, dependence on imports from a single supplier, existence of storage, political approaches towards gas in the generation mix). While a single European policy is unlikely to be delivered in five years, a target model will need to consider how to accommodate different and changing policy objectives in ways that do not adversely affect the overall development of an integrated market.
- Even in well-developed markets, licensing, tariffication and access arrangements continue to evolve in response to changing market conditions and policy objectives. BP supports the view that a conceptual model should be established at a high level such that it remains a stable reference point that can be used to steer towards convergence. The alternative of more detailed principles which might be subject to change (as for the electricity target model) would require governance procedures around how the target model will change. For instance, a broad statement on Market Coupling or enlarged balancing zones would be an appropriate high level principle that would be welcome as part of a concept model. Industry stakeholders would then be able to consider how (e.g.) renomination rights would need to change within the context of that principle, rather than have these set within the bounds of the model.
- The conceptual model should consider the role of different industry players. For example, there are important differences between member states in how TSOs are incentivised and rewarded for managing risk. As a result, there are substantially different approaches to the sale of interruptible capacity, the facilitation of secondary markets, willingness to invest in new capacity and the levels and firmness of capacity commitments to underwrite new investment. The consideration of rules on congestion management in isolation of TSO incentives risks creating inconsistency between approaches. The high level principles should provide a vision from which can be formed more detailed but consistent approaches.
- We support the view expounded by the Florence School of Regulation in their presentation of 3 December 2010 that the purpose and objectives of the model should be: *a non-binding top-down set of principles and characteristics; a tool for guiding and assessing the ongoing process of developing Framework Guidelines and the Regional Initiatives; take due account of wider energy policy objectives (Sustainability, Security of Supply)*¹.

¹ *Towards a target model for the European natural gas market – the academic view*, Sergio Ascari, 3 Dec 2010



Specific questions:

1. What are in your view the main goals to be aimed at by the gas target model beneath the high-level policy goals set out by the Third Package?

The goals of the model should be to increase consistency between networks and between member states and to improve clarity on changes in network access, tariffication and licensing in ways that reduce regulatory risk, or to make it more transparent and therefore calculable and manageable.

2. What are in your view the major developments and anticipated changes in the European gas market (on national and international level) and where would a target model bring added value? Including:

a. the role of long-term capacity contracts in the future European gas markets;

Clarity of forward tariff arrangements would help here, and potentially the ability to fix tariffs for the duration of the long term contract. Enforcement of non-discriminatory arrangements and requirements to publish (i.e. where legacy contracts exist, the same terms should be made available to all; if it is not possible to offer this, then the TSO should negotiate the termination of such legacy arrangements).

b. the role of hubs/gas exchanges

EC and ERGEG have played an essential role in reducing the number of spurious balancing zones or market regions that have fragmented trading in some member states. Nevertheless a question arises on the extent to which trading will respond to mandated establishment of hubs rather than allowing the market to determine where trading will consolidate. Where multiple trading points exist within a single system or member state, some regulatory intervention may be necessary to consolidate the number of hubs (especially if infrastructure investment or changes to tariffication methodology are required); at a regional level, hub consolidation should be determined by price convergence rather than regulatory fiat.

Similarly, the appointment of specific exchanges at trading hubs rather than allowing exchanges to compete in terms of services offered has created a situation where trading companies are deterred from using exchanges that don't offer acceptable contractual terms and conditions.

It should also be mentioned that the role of hubs and exchanges is an area which could be expected to change substantially as new legislation is developed on the trading of energy commodities and derivatives.

3. What are in your view the key elements of a conceptual model of the European gas market to contribute to non-discrimination, effective competition, and the efficient functioning of the internal gas market? Please include views on the key aspects of market design such as, capacity allocation and congestion management procedures, network tariff arrangements, wholesale market pricing, balancing arrangements and gas quality specifications? Please consider the interaction of these arrangements.

As stated in the opening section above, the abolition of legacy arrangements (or the introduction of the right to demand new contracts on same terms) is an essential feature of a non-discriminatory model. If long term fixed tariffs are to be offered, this may need to be finessed separately, though the fixing of long term tariffs may not be necessary if there is adequate transparency in the tariff setting process throughout the term of the commitment).

Clarity on gate closure and renomination restrictions (where there is currently a growing divergence in regulatory approaches between member states) will be necessary, together with how a redesign of capacity products (e.g. by splitting into "before" and "after" gate closure) will affect how the new products will be priced.



Greater commonality of balancing arrangements (again an area where regulatory approaches appear to be diverging) will be welcome including a statement on whether daily and sub daily balancing can co-exist as long as interface products between the two types of regime can be provided. This would include balancing periods, cashout, ability to carry forward imbalances (e.g. by park & loan linepack services), and renomination rights at cross border interconnection points. As a broad principle, where it is efficient and economic to use flexibility in one system to resolve an imbalance in a neighbouring system, this should be facilitated rather than prevented.

4. What level of detail, e.g. level of harmonisation, do you expect from the CEER vision paper on a conceptual model for the European gas market? For example:

a. Do we need a definition of an EU-wide gas day? If yes, what should the definition be?

Definition of a common gas day would be a useful statement to be contained in a conceptual model, as would arrangements to be put in place between regimes which retain a non-standard gas day. It may also be necessary to consider whether there is an impact on supply contracts of changing a transportation day and whether principles need to be established around interface products here. (E.g. if UK production contracts which are based on 06.00-06.00 (UK) are delivered into a transportation system that runs 06.00-06.00 (CET), then care should be taken to ensure that this does not lead to wholesale abrogation and renegotiation of existing arrangements. In the interim, it would be helpful to establish clear rules on how gas will be allocated when moving between regimes with different gas days..

b. How deep should the reach of the EU gas market model be, i.e. should it encompass DSOs? Is there a trade-off between vertical depth (i.e. including all levels of natural gas markets) and horizontal depth (i.e. integrating balancing zones cross-border)?

The model should initially focus on wholesale markets. Nevertheless where liquidity and competition are inhibited by low customer switching levels, it may be necessary to develop high level principles on how this might be addressed in a common framework.

5. Which areas or aspects of the gas market should be affected by the target model and what are the constraints for such a model?

We would divide the areas and aspects into two distinct areas: those related to network access terms and other terms.

- Network access terms would include: capacity, balancing
- Others would include licensing, tariffication, investment triggers

6. Which areas or aspects of the gas market should be excluded from the target model description and left to national/regional decision-making.

Retail market, security of supply, public service obligations. Governmental energy policy decisions will presumably be retained within member states. The model will need to consider a framework that will accommodate such differences without undermining the establishment of an integrated market.

7. What are the options for integrating the currently fragmented European markets? Are there any existing models you would like to recommend? In case your answer is yes, we would be interested to learn about the features of this model and if there are also any draw-backs in this model in your view?

We would recommend a governance process that allowed network users to propose changes to the network access conditions, which would be consulted and considered in an international as well as national context. A major concern among network users is that TSOs in many jurisdictions will impose amendments to their network access terms based on the TSOs' own agenda (and shippers have no option but to accept or to terminate the entire contract); there is no obligation on TSOs to consult with network users or consider their requests. The introduction of governance arrangements that allow network users to initiate change (and amend unsuitable proposals) would



allow the market to prioritise which are features that they wish to improve (including cross border and regional features). There is a crucial role for regulators to arbitrate between the TSO and its users on which proposals should be prioritized for consideration, and which amendments for implementation. These will be different from network to network depending on market maturity, state of advancement of access conditions, other local regulatory initiatives etc.

a. Should we merge balancing zones to create cross border or regional balancing zones or market areas? How many balancing zones does Europe need and how big should they be?

If adequate capacity is available (and expansions that are signalled are undertaken), and within-day short-notice renominations are allowed and are consistent between connected networks, then the market will determine through price-convergence where a market area will naturally be defined. The advantage of this over an imposed solution is that markets gain confidence over time as they gain in maturity over what transactions are physically achievable over certain distances and timescales. TSO experience also gains in this regard. In a model where mature trading hubs have developed with reliable price signals out into the forward market, this will also begin to provide an indication of the value of additional capacity to increase network flexibility.

b. Is the coupling of market areas as it is being developed in European electricity markets appropriate for gas?

We are extremely sceptical that the electricity model can be lifted directly onto gas, not least because of fundamental differences between the products' physical and economic characteristics, the geographical distances between production and markets, and the structure of pre-existing long term supply contracts. Nevertheless, the question of how to optimize underutilized interconnection capacity between market areas is common to both products. We would welcome an exploration and informed discussion of what could be learned from the electricity model but would prefer a broader consideration of how to address the underlying problems without locking into a specific (and questionable) solution at this stage that may have unintended consequences in areas affecting investment and future security of supply.

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