

CIEP reaction on ERGEG consultation roadmap EU gas market

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The Clingendael International Energy Programme (CIEP)¹ has read with interest the ERGEG discussion paper for a roadmap for a competitive single gas market in Europe. Both the sections on the current state of European gas markets and the one on action priorities are giving a relevant overview of the issues at stake in further developing the internal EU gas market. In its activities, CIEP is looking carefully at the developments in European and global gas markets, taking due account of competition issues and market designs in relation with supply security and long term investments throughout the value chain.

CIEP would like to stress its support for the energy policy objective to liberalise energy markets aiming at effective competition in both gas and electricity. This policy should however always be balanced with the other two main objectives of energy policy, i.e. security of supply and environmental protection. Designing markets and regulatory frameworks cannot be approached in isolation of these other policy objectives. In this respect CIEP is noting however that ERGEG is concentrating on the internal market per se and tends therefore to be somewhat inward looking. The external dimension is not getting the attention that is needed when a roadmap is to be defined. This external dimension will become more and more important as regional gas markets are more and more becoming integrated in globalising world gas markets.

In relation to the ERGEG Discussion Paper, CIEP would therefore like to make the following comments:

1. As a general notion, when discussing and developing regulatory regimes for energy markets, due account has to be given to prevailing dynamics in energy markets. This may be more relevant for gas than for electricity, because of the physical distribution of gas resources. Increasing EU import dependencies for natural gas are adding to already existing concerns on longer term energy supply security. ERGEG is no doubt aware of ongoing discussions in academic and business circles about possible paradigm shifts in energy markets and their longer term time frames for energy investments and overall supply security concerns. In these discussions questions are raised about the adequacy of the existing market and regulatory paradigms in meeting these concerns. For EU gas markets in particular, the perspective of increasing import dependencies together with the further globalisation of world gas markets is adding further dimensions to these issues. Again, discussing and developing regulatory regimes, regulators and policy makers will have to balance their activities with these dynamic perspectives. The discussion paper does not seem to refer to these issues of market dynamics and paradigm shifts and ERGEG should be invited to develop a view on them. CIEP therefore draws ERGEG's attention to work that CIEP is doing on these issues as a contribution to the debate for setting the regulatory agenda for worldwide gas markets for the next 5-10 years. CIEP expects to publish its material on these issues in the course of the coming months as inputs to the World Gas Conference (5-9 June, Amsterdam) and the Third World Forum on Energy Regulation (8-11 October, Washington).

2. More in particular, markets that are partly regulated such as European gas markets would require a model in which market dynamics together with longer term policy objectives are sufficiently translated into regulatory frameworks. If in general long term policy objectives are focussing on

¹ The *Clingendael International Energy Programme (CIEP)* is affiliated to the Netherlands Institute for International Relations 'Clingendael', based in The Hague and supported by seventeen institutions from the public and private sector. CIEP participates in and seeks to make a major contribution to the public debates on national and international developments in the energy sector. In its activities, CIEP is focussing on European energy market liberalisation, energy security of supply and geopolitical developments, and energy sustainability issues. See www.clingendael.nl/ciep.

adequate supplies of natural gas at reasonable prices, there is however a wide variance in regulator's statutory mandates in the EU on the interpretations for these policy objectives. For gas (probably more than for electricity), regulatory models should be able to address the market dynamics with the policy objectives in a pro-active way. Any market dynamics will lead to regulatory reactions which in themselves will trigger new market dynamics and so on. This dynamic regulation approach again requires a right balance between policy and law making versus regulatory interpretation and rule-setting. For EU gas markets, the EU-framework adds to the complexity of finding an adequate balance and it would therefore be appropriate for ERGEG to address this issue in its roadmap.

3. Again, security of supply will be a major issue, both for policy makers and for regulators. ERGEG is indeed drawing attention to this issue (paragraphs 101-103), but is limiting this attention towards the internal EU market component. What is lacking is the external dimension and the external supply security notion. Recent events have highlighted again the relevance of this notion. It would be in the view of CIEP rather naive to expect supply competition by Europe's external suppliers, when there will be increasing competition among consuming regions at global levels in the emerging world gas market. In addition, geopolitical factors will become more and more important in developing external EU supply relations and will increasingly influence global industry structures as a further instrument of these factors. This will impact securing external supplies to the EU and will necessarily impact as well prevailing market models. Economies of scale and scope and the necessity of establishing and enforcing adequate buying power in the global market, with increasing tendencies of becoming a seller's market will have impacts on internal EU competition and regulatory policies. ERGEG is therefore advised to address this issue in its roadmap.

4. Bringing more and more gas to European gas markets requires expansion of existing gas infrastructures. This will be true for pipelines as well as for LNG-terminals. These expansions would require massive investments, which will be forthcoming as required when regulatory regimes and climates do not present uncertainties and/or barriers. The gas industry will be challenged for developing the most appropriate coordination mechanisms throughout the gas chain that are needed for securing financing and risk management. These mechanisms could lead to various business models, including long term supply and transportation contracts and forms of vertical integration in the value chain. Business models could also lead to different modes for regulated and/or non-regulated infrastructure activities. The EU's Gas Directive 2003/55/EC gives in its article 22 a framework for granting exemptions to the EU's access rules when these rules would frustrate the development of new infrastructures. ERGEG is indicating in its discussion document that the issue of ensuring new investments will be addressed in the coming year (paragraph 114). CIEP would however stress the importance of this issue, as infrastructures and their business models would seem to be key in bringing and assuring new gas supplies to EU markets. These business models could have further impacts on other segments in the gas chain and could therefore go beyond the question of getting exemptions under article 22 or not. Also, regulatory competition within the EU (commodity pricing in national markets, siting of new pipelines) but also at global levels (US rules for new LNG terminals) could play a role. CIEP is therefore noting with some surprise that this issue is not mentioned as a priority action in ERGEG's roadmap.

5. In addition to the point raised in section 4., the issue of intra-EU transits for gas coming from outside the EU, is not mentioned in the discussion paper. CIEP is wondering whether or not there is a need for discussing two different approaches. The one is that once gas is landing the EU gas market, either at the connection point or at the terminal, the question could be raised how much access is assured after the landing or regasification point. Is gas, once connected or landed, freely tradable or not? The other approach is that of a transit line under EU jurisdiction. Is there a need for a separate regulatory approach for the EU-transit part, with or without pipe-in-pipe type of concepts? These issues would seem to require attention as well, even maybe refining the context of the article 22 exemptions.

6. Another item, which according to CIEP should be dealt with in the roadmap, is the question of seasonal storage capacity. Increasing gas demand together with increasing import to the EU will lead to an increasing need for seasonal storage, due to the difference in load factors between supply and demand. CIEP is about to publish a study on this issue, which identifies several risks to storage investment. Such risks could lead in the medium future to a relative shortage of seasonal storage. A less comfortable endowment with storage capacities would result in price volatility and very high prices in wintertime. The storage market should also be discussed against the background of the re-emerging discussion on supply security standards. CIEP therefore suggests to ERGEG to include the issue of seasonal storage in its roadmap.

7. As the growth in EU gas consumption will largely be driven by the power sector, the interaction with the electricity market and also with the emerging carbon market will become more and more important. These interactions will also be influenced by regulatory regimes. If these regimes are not sufficiently consistent with each other, market distortions might occur with resulting price volatilities and sub-optimal market outcomes. The awareness of getting these regimes more consistent should also be put on the agenda and would, according to CIEP, require a separate mentioning in the roadmap that ERGEG is proposing.

8. The common EU dimension is the final point that CIEP would like to raise. CIEP agrees that the EU gas market will see no doubt a number of developing regional markets within the EU, as ERGEG is describing in section 5.1. These initiatives, as with electricity, would allow tailor-made approaches based on the particular regional market's situation and needs. On the other hand, inter-regional, but intra-community trade might also be expected and may be even promoted. Efficient hub-to-hub trading would no doubt add to effective market outcomes and therefore some degree of overall umbrella-type of modelling would seem to be necessary for these regional initiatives. CIEP would welcome any view from ERGEG on this EU-wide type of thinking, including the possibility of a further governance model for EU energy markets.

In summary, the Clingendael International Energy Programme, would welcome any further discussion on the evolution of EU gas markets, not so much from an inward looking point of view, but also - and maybe even more expanding- from a global gas market perspective. CIEP is willing to contribute to this debate and is looking forward to further dialogues and interactions with all parties concerned.

(signed)

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