

Brussels, 14 January 2011

POSITION PAPER

E10-PC-59: CONCEPTUAL MODEL FOR THE EUROPEAN GAS MARKET – CALL FOR EVIDENCE

Introduction

FEBEG is the Belgian sector association representing the common interests of gas and electricity producers, traders and suppliers.

FEBEG welcomes the opportunity to comment on the ERGEG Consultation Paper.

Preliminary remarks

1. FEBEG believes a Gas Target Model (GTM) for a pan European transport system is important to come to a converging process towards an integrated European gas market.
2. The Third Energy Package prescribes the development of network codes. FEBEG strongly supports the development of a complementary non-binding GTM within the scope of the Third Energy Package and other existing legislation to provide guidance on the design of framework guidelines and network codes: the GTM should ensure consistency by identifying and resolving potential conflicts between the various network codes.
3. FEBEG only sees the need for a GTM for the natural monopoly part of the market. Price forming for natural gas should be left exclusively to the market.
4. Furthermore FEBEG is of the opinion that the GTM cannot be implemented disregarding existent rights of market parties.

Answers to the 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 3rd Package?

GTM should be focused on transport issues:

1. the GTM should – in the most cost efficient way and not exceeding the overall economic welfare of the measures - facilitate competition, efficiency and security of supply;

2. a consistent and predictable regulatory and market framework on an European level;
3. transparency and harmonized information on all transportation related topics within the scope of the Third Energy Package;
4. harmonized capacity congestion management;
5. optimization of investments and use of the network from an European perspective rather than a single TSO perspective based on cost/benefit analysis.

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?

Certain evolutions (use of gas power plants as flexible back up for renewables, decline of households' consumption, integration of peripheral gas markets, domestic production from unconventional resources, ...) will make the European gas market less predictable. Therefore, the GTM should promote capacity.

In that perspective, and to avoid bottlenecks, coordination of cross border investments is needed. Therefore the GTM should provide an effective process to coordinate cross border investments based on market reflective investment incentives and taking into account – in a balanced way - all drivers for long term investments, including price signals of shippers via open seasons/structured auctions as well as market consultations on prospective studies or long term planning by ministries or regulators.

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

Long term contracts are important to provide security of demand to producers and security of supply to the European market. To ensure this long term gas transport contracts should also be possible. Long-term transport contracts should be valued and respected but shouldn't lead towards closed markets. So a key role of the GTM is to find a model that facilitates both long term and short term transport contracts.

b. the role of hubs / gas exchanges

Hubs are a key element of a well functioning gas market and a logical consequence of a development towards entry-exit systems. Gas prices will be increasingly based on the hub price in a certain market area. Hub to hub trading could be stimulated by developing capacity products between hubs. This should be optional - not obligatory – and have no impact on the capacity on the market. A European gas market will exist of several hubs and price areas based on network topology and commodity prices. Regulators should not identify or appoint the location of hubs and/or market areas. Fostering the development of the hubs, should not be unduly detrimental to freedom of trade.

c. Gas quality issues

The TSO is responsible for the gas quality in the grid and the measures to safeguard this gas quality. This is a public service obligation. Variable gas quality specifications (GCV on capacity booking, ...) should not have any influence on commercial agreements.

3. What are in your view the key elements of a conceptual model for 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.

(See answer to question 1)

FEBEG considers following key elements as essential for a GTM:

1. the GTM should – in the most cost efficient way - facilitate competition, efficiency and security of supply;
2. a consistent and predictable regulatory and market framework on an European level;
3. transparency and harmonized information on all transportation related topics within the scope of the Third Energy Package;
4. harmonized capacity congestion management;
5. optimization of investments and use of the network from an European perspective rather than a single TSO perspective based on cost/benefit analysis.

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 this definition be?

Yes, it would help if the gas day would start and end at the same time across the EU and renomination times were harmonized.

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 national gas markets) and horizontal depth (i.e. integrating balancing zones cross border)?

The EU target model should include rules for transmission grid access at the level of wholesale markets. Regulation for downstream distribution grids will likely need to be designed by national regulators such that they do not contradict with rules for the upstream grids / markets. Horizontal integration should not be hampered by issues of vertical integration.

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?

(See 2nd preliminary remark)

The Third Energy Package prescribes the development of network codes. FEBEG strongly supports the development of a complementary non-binding GTM within the scope of the

Third Energy Package and other existing legislation to provide guidance on the design of framework guidelines and network codes: the GTM should ensure consistency by identifying and resolving potential conflicts between the various network codes.

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

(See 3rd preliminary remark)

FEPEG only sees the need for a GTM for the natural monopoly part of the market. Price forming for natural gas should be left exclusively to the market.

The GTM should identify the issues which should be regulated at a regional or national level and not on a European level. The type of balancing regime is an example of an area which should be left to the level of the market zone, since every grid has its own characteristics that need to be taken into account.

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.

Before analyzing those methods, the objectives to integrate the currently fragmented European gas markets should be defined under consideration of the following aspects:

- price convergence;
- efficient utilization of existing infrastructure;
- portfolio effects and ease of handling for shippers;
- synergy effects with other markets, especially the electricity market.

Based on these objectives, the implementation of the following measures should be discussed and their costs and benefits should be assessed with all involved stakeholders. The analysis should include an assessment whether temporary or permanent measures are more cost-effective. The overall costs shall not exceed the overall economic welfare of the respective measure.

Furthermore FEPEG would like to point out there is a difference between coupling gas markets and integrating gas markets. Market coupling cannot just be copied from the power sector: the market coupling solution should be carefully analyzed and assessed taking into account differences between power and gas sector, for example due to own national production the cross border transmission in the power sector is relatively small – in terms of capacity and in terms of revenues - compared to the gas sector.

Explicit Day-Ahead Auctions / Hub-to-Hub Products

One possible measure to enhance integration of market areas is the non-discriminatory and transparent offer of additional short-term capacity. To this aim in particular day-ahead capacity should be created or reserved. In this option it is allocated via explicit capacity auctions.

To further facilitate these capacity auctions and hub-to-hub trading, any new capacity between market areas can be bundled. The requirement to adapt existing contracts to new legally binding rules should not be used to change existing capacity reservations. Sanctity of contracts is an important principle in the gas industry to ensure a sound investment climate that is pivotal to long term security of supply in the gas industry.

Such hub-to-hub products combining exit and entry capacities into one product are currently being developed at a number of European cross-border points. Examples are “Link4Hubs” connecting the Dutch, North-German and Danish gas markets and the bundled capacities offered on “Capsquare” connecting the Belgian and North-French gas market. The experiences being gained with such pilot projects can feed into the development of Europe-wide definitions.

Implicit Auctions/ Market Coupling

Another possible measure is the introduction of implicit auctions/ market coupling. Up to now, such an approach has not been implemented in the European gas market. In order to carry out a qualified discussion on this, a joint understanding of the main mechanisms needs to be developed under consideration of the following elements:

Both CMP and CAM framework guidelines are going to be applied in 2011 and their effects should be studied first, before suggesting another congestion management measure.

Efficient integration into the existing production, import, and storage markets.

Potential of this congestion management measure to collect the relevant investment sums to remove the congestion physically.

Merging of Balancing Zones

A third option for integration of adjacent markets is a full merger of balancing zones. This is considered as a complex measure. Experiences have shown that too large zone sizes may lead to adverse effects on the amount of firm capacity. In order to guarantee freely allocable entry/exit capacities additional control energy, load flow commitments or alternatively infrastructure investments are needed.

In addition, this option requires full harmonization inter alia of the balancing regimes in both markets. Joint efforts of Member States, regulators, TSOs and network users are required to achieve this.
