Union of the Electricity Industry - EURELECTRIC
comments to the ERGEG discussion paper
"Roadmap for a competitive single gas market in Europe"

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This paper has been drafted by the EURELECTRIC WG GAS in January 2006.

Vincenzo CAVICCHIA (IT, Chairman)
Elwin DELFGAAUW (NL), Gwyn DOLBEN (UK), Jesús FERNÁNDEZ LÓPEZ (ES), Steve GORDON (UK), János GYOREI (HU), Pierre HANUS (FR), John L. HARRIS (DE), Marcella MOLINARO (IT), Inge PIERRE (SE), Conor PURCELL (IE), Anton SMOLAK (AT), Giovanni TAGLIALATELA (IT)

Anne-Malorie GERON (EURELECTRIC), Gaël GLORIEUX (EURELECTRIC), Edith HOFER (EURELECTRIC)

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The **Union of the Electricity Industry - EURELECTRIC** is the sector association representing the common interests of the European electricity industry and its worldwide affiliates and associates. Its mission is to contribute to the development and competitiveness of the Electricity Industry and to promote the role of electricity in the advancement of society.

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Comments on the ERGEG discussion paper
"Roadmap for a competitive single gas market in Europe"

EXECUTIVE SUMMARY

EURELECTRIC welcomes ERGEG's discussion paper, which seeks to propose practical steps towards a competitive single European gas market. The need to promote liquid trading at - and between - gas hubs is strongly supported by EURELECTRIC. If progress is to be made, it is important that the building blocks for a competitive market are in place and EURELECTRIC believes that regulators should focus particularly on the implementation of the existing legislative package. If the differential pace of change in the Member States continues, it will become increasingly difficult to move towards a single market with consistent arrangements and EURELECTRIC therefore underlines the need to speed up the liberalisation process in the gas sector.

The proposed examination of gas trading region-by-region will facilitate the identification of specific trading barriers and is therefore a welcome development. In particular, EURELECTRIC supports the proposal to analyse the existence of **regulatory gaps and operational aspects relating to cross-border activity**. However, **promoting trading in regional markets** can potentially pose problems for the creation of the wider single European market, unless there is a **concerted attempt to ensure that all markets develop in the same direction**. This is already acknowledged in many points of the ERGEG paper but EURELECTRIC believes that this should be further emphasised in the proposed work plan. Furthermore, the strong European dependency on gas imports and the results of the sector enquiry should also be carefully taken into account.

Essential prerequisites for a single and competitive EU gas market are:

- investment in transportation infrastructure, including making pipeline capacity available, and in the development of LNG terminals and storage facilities,
- securing adequate supplies of gas.

Without these two crucial elements, a fully-fledged competitive and liquid EU gas market cannot develop even if the appropriate regulatory framework is in place. In particular, in a situation where available gas is scarce and infrastructure constraints exist, prices can be driven up with potential implications for security of supply. EURELECTRIC welcomes all developments towards such a liquid and competitive gas market, recognising the need for long-term and secure supplies in a context where gas is growingly important for electricity generation and where the EU depends on imports. This dependency can however not justify any sort of discriminatory access conditions to gas infrastructure.

EURELECTRIC takes the view that the proposed work plan should in particular include:

- analysis of the **interface between adjacent regions** before deciding on an action plan for each region. The key regulatory and operational measures facilitating cross-border trading should, once identified in one of the regional studies, also be considered for all other regions;
- analysis and definition of the necessary actions to remove obstacles to liquidity in gas trading for import;
- identification of the EU infrastructure (including storage), which is limiting gas trading;
- better grouping of Member States when defining regional markets (e.g. Italy alone makes little sense).

We consider it vital that each of the regional reports and studies respond to the above mentioned questions as they are key to achieving a single EU gas market.

EURELECTRIC answers to the questions raised by ERGEG in the discussion paper

GENERAL

- Does this paper identify the main problems in European gas markets today?

EURELECTRIC shares ERGEG's analysis on the main factors influencing progress towards a liberalised gas market. As correctly explained in section 4 of the discussion paper, and as demonstrated by DG COMP's Issues Paper on the gas sectoral enquiry, gas markets are still far from being competitive in the majority of Member States. They are even further away from being sufficiently integrated to form a European gas market.

The ERGEG discussion paper draws attention to the EU's strong dependency on gas imports. However, it does not fully bring out the consequences of this situation. In particular, import dependency means that the regulatory regime in export and transit countries adversely affects competition inside the EU. For example, **access conditions** for transmission import pipelines are often discriminatory (with negotiated access where the main conditions are not made public) and the operational decisions are not always transparent. Moreover, available capacity is insufficient and investments to increase it are not being made.

In the ERGEG paper high priority is given to **transparency**. Transparency in relation to network access and operation is crucial and regulators should pay particular attention to compliance with the Gas Regulation. Transparent charges and access terms, together with information on gas flows and availability are needed to inform the market and promote competition.

LNG terminals and storage are highly beneficial to liquidity and security of supply. Although new entrants have an interest in investing, the building of new infrastructure is often delayed or even blocked altogether because of serious obstacles such as the local public non-acceptance of LNG terminals. The proposed ERGEG study should therefore also identify barriers to the building of new infrastructure and make a proposal to overcome them.

- Does ERGEG's proposed way forward address your concerns, or, if not, are there other actions you believe that the Regulators need to take?

Further emphasis should be paid to identifying the necessary actions to **remove obstacles to liquidity in gas trading for imports** into the EU. It should also be noted that within the gas business upstream activities (production and gas imports) have the largest economic margins.

Regulators have a key role to play in implementing existing legislation and EURELECTRIC would like to see them give particular priority to ensuring full compliance with the Gas Directive and Gas Regulation in their own Member States.

INTRODUCTION

- We particularly welcome, in response to this consultation document, examples from industry participants of problems experienced in European markets that demonstrate the existence of obstacles to further progress towards a competitive single European gas market.

Existing capacity reservations, the lack of adequate pipelines both outside and inside the EU, together with the obstacles to building new LNG terminals are all factors which lead to a lack of sufficient available gas for new entrants. As demonstrated by the DG Comp study, accessing the European gas market is as difficult as ever for many potential market players.

- Regulators welcome feedback on the concept of the regional market in gas.

The development of regional markets, as a first step towards a single European market, has some merit but it cannot be transposed identically from the electricity to the gas sector. Key differences exist between these two sectors, in particular because gas often has to be shipped across several Member States due to the EU's dependency on gas imports. Electricity cannot be transmitted economically over long distances, so that power generation facilities are more evenly spread across the EU and there is less physical trade across borders. 21 of the 23 Member States that consume gas are strongly dependent on imports to satisfy their national demand. Therefore, national gas markets are affected by the liquidity and network access conditions in export and transit countries, a problem for which no rapid solution is likely. It is however possible that some higher flexibility can be achieved with the growing role of LNG imports. Swaps can help as well but with the limitation that an amount of gas at least equal to the national demand must be physically available.

It is thus of utmost importance to establish an appropriate action plan for the removal of barriers to access to upstream gas sources and to promote liquid trading of gas imports into the EU (e.g. by tackling discriminatory conditions, negotiated access and lack of available capacity in non-EU pipelines owned by incumbents).

We would also welcome initiatives to analyse the existence of regulatory and operational obstacles. These should be accompanied by an action plan for removing them, which is sufficiently harmonised to allow regional markets to contribute to the construction of a single European market.

CURRENT STATE OF EUROPEAN GAS MARKETS

- Regulators would like to hear the views of respondents on whether there are other important regulatory gaps not discussed here.

The ERGEG discussion paper correctly points out that the regulatory instruments should be commensurate with the dimension of the market under consideration. In the framework of an EU-wide market, regulators need to cooperate more closely on cross-border issues. EURELECTRIC believes it is important to identify differences in the national implementation of the Gas Directive and Gas Regulation, which are having a negative effect on trading. Key principles need to be harmonised at European level.

Great attention should be paid to avoid the different regional markets developing in a divergent manner. Thus, the project of developing regional markets should include one phase where the interfaces between adjacent regions are analysed with a view to the intended creation of a single EU gas market. This should especially be the case where current exchange flows are already significant.

- Long contracts give security to investors, but may frustrate the development of effective competition. Under the regulated approach, what steps are needed to provide the necessary degree of security to investors (for example, the existence of a regulated asset base)?

Europe is highly dependent on imported gas. Long-term contracts are important for the EU market and for the electricity generators investing in gas power plants so as to ensure security of supply. It is therefore clear that competition has to be introduced in a way which maintains the ability of companies to manage the risks associated with long-term investments. The problem at the moment is that most EU cross-border capacity is reserved for existing contracts, while investment in new infrastructure is not adequate. The construction of LNG terminals is also delayed in several countries.

The short-term problem is thus the lack of available cross-border capacity. One concern in this respect is that new investment is in most cases a TSO decision and that some TSOs might not have a commercial interest in increasing capacity. Therefore, where investment is inadequate, regulators or Member States should have the powers to require that the necessary investment takes place. The most appropriate solution in this respect is that regulators should incentivise investment in cross-border capacity, i.e. ensure an adequate return on this type of investment, bearing in mind the longer time frame. It is clear that, in this framework, adequate investment in cross-border infrastructure needs a coordinated policy among regulators.

- If the two approaches co-exist (for example, where non-regulated infrastructure outside the EU meets regulated infrastructure inside the EU at the border), what issues are raised by the interaction? Finally, how do legacy contracts fit into this picture?

Access conditions to gas import pipelines are today frequently discriminatory, as incumbents are given access to import pipelines on more favourable conditions than other stakeholders, and strategic investment decisions on additional import capacity might also effectively disseminate against competitors. In the downstream market (inside the EU), this means that incumbents are able to import gas at more competitive conditions for the final customer. Downstream competition is thus affected by lack in competition in the upstream market.

What is important to address at the moment is the fact that many of the pipelines are contractually booked for incumbents' long-term contracts.

<u>PRIORITIES</u>

- Pancaking of transaction costs could be dealt with by requiring TSOs to co-operate such that market participants would only contract with a single TSO. Alternatively, independent third-parties could offer a commercial service that would manage the interface between network users and multiple TSOs. Regulators are interested to hear the views of market participants on a) whether there is a market need for such a service, and b) if there is, should TSOs be obliged to offer it?

In EURELECTRIC's view, the objective is to achieve the highest possible level of harmonisation of cross-border trade. This can only be achieved by requiring that TSOs co-operate in such a way that market participants contract solely with a single TSO for a specific pipeline. TSOs should cooperate with each other on further harmonisation of tariff methodologies and day-to-day procedures. Pancaking and bureaucratic barriers also arise from differing access rules (including non-matching timing, differing allocation mechanisms etc.), which in fact produce significant obstacles to cross-border transportation.

- Regulators would like to hear the views of respondents on the possible advantages and disadvantages of an ITC scheme covering the EU-wide gas network.

An ITC scheme would much simplify access to networks. It would also be a very concrete step towards creating a single EU market for gas.

- Regulators would be interested to hear the views of market participants on how the detail of the regulatory framework should be developed to ensure an appropriate allocation of risks between infrastructure investors and users.

An appropriate allocation of risk could be ensured via a regulated tariff system plus strong coordination among regulators.

<u>ROADMAP FOR A COMPETITIVE SINGLE GAS MARKET IN EUROPE. THE WAY FORWARD</u>

- Respondents are requested to comment on the appropriate definition and selection of regions for the regional initiatives.

The definition of regional markets "corresponding to geographic areas in which it is possible easily to retail gas available on the wholesale market at a nearby hub" does not seem to take account of the barriers to wholesale gas liquidity that are due to other EU transit countries. EURELECTRIC believes that regional markets should reflect groupings of countries that at present are strongly dependent on other EU transit countries. In this way, the proposed detailed region-by-region examination would provide evidence of the situation in gas trading and enable the identification of specific trading barriers.

For example, considering Italy as a single region when it has already had four years of experience of an entry-exit tariff system and capacity booking system does not seem to make sense. Because Italy is dependent on both Algerian gas and on gas imported via its northern border, it would be more appropriate to group it with other regions (such as northern-central Europe) in order to analyse obstacles to cross-border trade.

The results of the European Commission's **sector enquiry**, which has analysed hundreds of gas contracts and detailed national situations on the basis of 3000 interviews, should be taken into account in the ERGEG work programme.

- Regulators would like views from stakeholders on some specific questions relating to the identification of relevant regions:

- **physical congestion at border crossings is important in gas markets, and what is the relative significance of contractual constraints?**

  Point 26 of the ERGEG discussion paper indicates that congestion at borders appears to be less significant in gas than in electricity. Yet the preliminary results of the sector enquiry show that there will not be any available capacity for the next decade on Europe's two main transit routes. Better use of the present capacity could free up some capacity and EURELECTRIC supports action in this direction. However, the need to increase import capacity (via new pipelines, upgrading of existing pipelines or the construction of LNG terminals) will also remain.

It is also crucial to clarify in detail the Commission's statement at the Xth Madrid Forum, according to which: "relevant provisions of the Regulation on conditions for access to the gas transmission network and the second Directive apply also to transit contracts concluded before the entering in force of this Directive".

- **In what way is this situation likely to change with increasing imports in the future?**

  In case of increasing imports, the situation described above can only worsen. It must be underlined that the congestion problem is not only relevant for EU internal infrastructure but also, and even more so, for EU import infrastructure.

- **How can different regions be distinguished in terms of:**
  - **the sphere of influence of different gas hubs;**
  - **physical and/or contractual constraints at the region's borders;**
  - **different pricing mechanisms;**
  - **other (explain)?**

The regional definition, while potentially useful from an analytical point of view, has only limited practical application (sphere of influence, contractual /physical constraints etc).