

**Comments by the European Federation of Energy Traders  
on the ERGEG Discussion Paper Ref: E05-SEM-13-03 (21 November 2005)  
Roadmap for a competitive single gas market in Europe**

**Summary**

The priorities for achieving a fully liberalized gas market by July 2007 need to recognise the different status of gas markets throughout the EU. EFET supports ERGEG's regional approach as a pragmatic way forward, but it must be well co-ordinated so that regions do not diverge from the shared goal of a European gas market.

EFET welcomes the strong focus on gas hub development. We suggest that the initial effort should be to improve liquidity and cross border trade between the existing trading points in Belgium, the Netherlands and Northern France: This would be a pilot study in an established area of regulatory cooperation. The **Zeebrugge TTF PEG Nord** study should identify actions that will stimulate further trading at and between these hubs. Lessons from this can be applied more widely to help develop other hubs.

Key issues to encourage optimum hub development should include information provision, firmness of the hub, cost of back-up services, access to & from the hub, and the balance of risks and liabilities.

The establishment of proper entry-exit regimes, including the creation of virtual hubs with facilities for title transfer and trading of imbalances, currently offers a good way forward for gas hub development. Trading will not develop unless the competitive conditions are appropriate. A regional approach should aim to remove barriers to trade, so that gas hubs can develop and gas can flow internationally.

Priority should be given to:

- Providing **information transparency** for the use of all main infrastructure and necessary services
- Achieving fully effective unbundling of all main infrastructure operators so that there is **non-discriminatory access to all services** needed to enable trading at and between hubs.
- Addressing barriers resulting from legacy agreements (mainly transit) through capacity release or other stimuli to **capacity trading**.
- Aiming for **market-based daily balancing** throughout Europe, and the provision of within-day information by the TSOs

The roadmap needs to complement the implementation of existing EU legislation, in particular the new EU Gas Transmission Regulation 2005/1775 for which there should be compliance by 1<sup>st</sup> July 2006.<sup>1</sup>

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<sup>1</sup> See [www.efet.org](http://www.efet.org) Gas position paper January 2006, Priorities for implementation of the Gas Transmission Regulation,

## General comments

EFET welcomes this consultation and shares ERGEG's vision of "effective competition delivering real benefits for gas consumers throughout the EU; a stable regulatory framework facilitating efficient levels of investment; secure supplies; choice; and gas suppliers able to market their services to all consumers across the EU". But **the goal must be to achieve this vision in line with full liberalization** of the market as required by EU Directives no later than July 2007. A long-term vision also needs to be addressed, but this should relate to new international gas supplies and further potential EU expansion – both of these are issues for the next decade and completion of the internal energy market should have been completed well before then.

We share ERGEG's aim "to deliver practical improvements to European gas markets" and support the **regional initiatives in parallel with issues addressed at an European level**. The emphasis now must be on identifying and taking action on those issues that will make real improvements in European gas trading conditions. EFET therefore strongly support ERGEG's immediate priority "to take steps necessary to promote liquid and competitive trading at and between gas hubs". We agree that "liquid and competitive wholesale markets are a prerequisite for the benefits of competition to flow to end users" and we suggest that "traders" should be explicitly included as interested parties (not just network users), as only traders can provide experience of trading and only if a hub is actively traded it is of any use! The time is now right to identify, prioritize and solve the problems that are preventing the development of robust and transparent traded gas markets throughout Europe.

In this respect it is clear that **traded gas markets can only develop where there are sufficient opportunities for competing gas supply** companies. ERGEG has listed issues including; access to capacity, incentives for investment, information transparency, availability of gas; communication and transaction arrangements; cross-border compatibility (eg, of balancing and flexibility regimes); cross-border capacity; regulatory arrangements and gaps relating to cross-border activity – many of which are barriers to gas supply competition as much as to gas trading. In particular lack of information about the flows, available capacities and costs of using the whole infrastructure connecting hubs (or potential hubs) remains a serious barrier to trade throughout much of Europe.

EFET considers that the **questions and action plan approach** is both relevant and sound, but express concern that the start of implementation of any action plan will not be until 2007; where no new legislation is needed, improvements should be put in place as the work progresses during 2006 rather than waiting until 2007. Provided that there is a shared determination by the regulators to help implement practical improvements during 2006 then EFET looks forward to working with other market participants to make "trading at hubs within the regional market, and hub-to-hub trading within and between regional markets" a reality.

In ERGEG's introduction there is, however, at least one erroneous assumption, which needs to be corrected if the roadmap is to have the right starting point. For example, the incorrect statement that **congestion at borders** appears to be less significant in gas markets than for

electricity is not in line with the findings of DG Competition's Energy Sector Inquiry Issues Paper presented to the December 2005 Energy Council<sup>2</sup>

Of course the situation is not the same as in the electricity market. It is well known that, unlike electricity, most of Europe's gas supplies have to cross international boundaries. Those companies with long-standing arrangements to use this cross-border or transit capacity may well not be experiencing any congestion, whereas third party access to those same pipeline routes is denied to or made uneconomic for potential competitors.

Overall, the goal of improving liquidity in the wholesale gas market means that it is essential to have sufficient information from the hub operators to enable an ongoing quantitative assessment of liquidity. Once more, information transparency is fundamental to the success of the internal market.

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<sup>2</sup> See point (47) onwards. For the routes DG Comp analysed, pipes were found to be fully booked for periods of 10 years and more, while point (49) suggested that there remains an "average" of around 10 % unused capacity,

**EFET responses to ERGEG's "Summary of questions"**

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

*Yes, the framework is pragmatic, but it requires a greater focus on one or two trading areas, while at the same time urgent resolution of the barriers to the development of competition throughout Europe is needed.*

*In terms of timing, EFET's priorities to ensure that key issues are given adequate weight early enough in the process are as follows*

- a) **transparency** issues across borders should be the top priority. EFET suggests that GIE produce and keep up to date an on-line map where users can click on each border point, and then you can see all information issues (via links to the appropriate TSO websites), in consistent format and units. Once in place everyone will be able to evaluate the information and its provision. It will also be possible to see the best practices in transparency, and TSOs will learn from each other; current inconsistencies of (e.g.) available capacities on cross borders will also pop up very clearly*
- b) **access** to entry-exit systems is the second phase (e.g. the on line booking systems); here again, this is quite easy to implement, and once installed everybody will be able to see directly if capacity (e.g. from north Europe to south Europe is available or not )*
- c) third, we should work on the **secondary capacity market**, including a harmonised implementation of UIOLI principles and with TSOs facilitating these markets,.*
- d) still very important, the 4th priority is balancing, but daily **market based balancing** will be very difficult unless the previous three issues have been tackled.*
- e) transportation tariffs based on consistent methodologies will be an ongoing issue for the regulators to deal with. Verifying tariffs, and how to benchmark legacy contract tariffs versus shorter term tariff issues will need continual assessment. The key is to ensure that the tariff methodology provides the right incentives in the regulated regime to result in TSOs building sufficient capacity on time to meet market demand*
- f) Resolving gas quality issues (see appendix)*

*Specific priorities for gas hubs are dealt with in the answer to the regional approach.*

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

*Our concerns are set out above. The aim should be to resolve as many problems as possible during 2006.*

## **ERGEG's Introduction & Regional Approach**

**- 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**

*As a trade organization EFET is not in a position to publish information on individual cases. The DG Competition Inquiry has exposed a plethora of problems including market concentration, vertical foreclosure, insufficient market integration, lack of transparency, and price issues.. What is needed now are solutions.*

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

*. EFET agrees broadly with the approach, but would make two suggestions*

- 1. a sub-grouping within the NW Europe region so that the real practical issues relating to trade at and between the emerging hubs in The Netherlands, Belgium and (Northern) France can be addressed. EFET Members would be prepared to be particularly active in such a group*
- 2. the combination of Southern and Eastern Germany in to the 'Baumgarten' Group, the inclusion of the Czech Republic and the combination of this group with Italy, to form a S&C Europe region.*

*The regional approach would therefore become:*

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– NW Europe: Northern France, Belgium, UK, N&W Germany, Norway, Netherlands, with a sub group focus on PEG Nord, Zeebrugge & TTF that will carry out a **pilot study as set out in the summary.***

*– C&C Europe: Italy/Austria/Hungary/Slovakia/Czech Republic, S&E Germany (with a focus on PSV & Baumgarten)*

*– SW Europe: Spain/Portugal/ southern France*

*– at least one region with no currently operating hubs, probably the NE*

*Within the NW Europe region, EFET would be able to contribute analysis to assist in transnational harmonization of best practice, not only in relation to the hubs themselves, but also regarding market-based balancing, entry-exit access systems and capacity trading.*

*The main **priorities** that need to be addressed as a pilot study by the NW Europe sub-group are*

*Zeebrugge*

- a) at the hub*
  - a. Firmness and backup/backdown pricing*

- b. *The location and possible expansion or 'move' of Huberator*
  - c. *Hub not an exit point for domestic transport*
- b) *adjacent the Hub*
- a. *LNG access arrangements, UIOLI, profiling, gas quality (e.g. issues in relation to German and UK systems)*
  - b. *Storage access, transit linepack and imbalance issues*
  - c. *Pricing and the availability/allocation/open-season for Transit and transmission capacity*
  - d. *Flow issues to and from TTF and PEG Nord*

#### *TTF*

- a) *at the hub*
- a. *Hesitant participation of major player*
  - b. *Credit/Liability issues*
  - c. *Stimulating physical delivery at TTF*
- b) *adjacent the hub*
- a. *the new balancing & flexibility rules*
  - b. *Entry capacity availability*
  - c. *Gas conversion (High / Low Cal) service*
  - d. *City gate destination clauses that reduce TTF liquidity*

*The PEG appears like a sound market framework, but has serious issues:*

- a) *lack of available capacity (not clear if this is a physical or commercial problem)*
- b) *insufficient access to storage and lack of confidence that access is non-discriminatory.*
- c) *lack of a balancing market (tariffs are based on a foreign price index)*
- d) *'regulated' final prices*

*All this leads to the lack of competing suppliers, and the resultant lack of customer switching in the downstream 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.**

*EFET considers that strong independent regulation [of access to infrastructure and necessary services] is an important feature of a successful traded market. However, the different levels of independence and power of Regulators throughout Europe does increase the risk of regulatory arbitrage, particularly for assets that may have a role across borders.*

*We believe that Regulators should develop either multi-party or bilateral agreements on how to handle and consult on cross border issues (such as TPA exemptions) and may also include processes for the collection, sharing and if necessary dissemination of information. The*

*effectiveness of any such agreement(s) will be hampered by the diverse powers and responsibilities of different regulators, but these gaps should become more transparent. Improved transparency will also help regulators trust each other and be more efficient.*

*Regulatory gaps may be problematic for the development of the market, but similarly regulatory overlap could cause confusion and unnecessary costs. Many firms operating in European markets are also subject to financial regulation because they are regulated entities or because they operate on regulated exchanges. Both Financial and Energy Regulators may have similar concerns about the behaviour of market participants and may instigate investigations. Energy Regulators and Financial Regulators should ensure that investigations and inquiries are handled in an efficient manner without introducing delay to regulatory input and decisions.*

Transparency helps to improve regulatory efficiency.

**- 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)? 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?**

*EFET recognises the importance that long term contracts have had in giving security to investors in new infrastructure projects. Where a TSO is subject to full unbundling and offers the same TPA services to all parties it should not matter that some of these services are sold over a longer time period, they should however be consistent with the development of competitive markets. A similar approach can be adopted with legacy contracts. The existence of such contracts should not be of concern if these contracts apply the same TPA rules that are present for all users in a fully unbundled system and that unused capacity is made available on the secondary market or through appropriate Use it or Lose it arrangements.*

*Of fundamental importance to new users of a pipeline or storage system is that they are not disadvantaged compared with the existing users. It is essential therefore that if legacy long-term arrangements remain in a regulated system, (for example a major transit pipeline) then the terms offered to new users of the system are no worse than those enjoyed by the long term capacity holder.*

*For systems where regulated and non regulated infrastructure meets or is proposed then the rights to enter the TSO's systems should be the same for all parties, whether they come from a regulated system, LNG Terminal or an unregulated import pipeline. TPA arrangements should enable a consistent approach to investing in and allocating capacity to users of the system.*

## **Priorities**

**- 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?**

*Optimal combined system operation is an essential goal for a single market, or the duties of Independent System Operators covering more than one TSO area. 'Pancaking' can occur not only of transaction costs (associated with booking capacity in several systems) but also of access tariffs, which may then become a significant barrier to cross-border trade. A further issue is the diversity of processes for obtaining and using access. Standardisation is an important element of improving cross border efficiency. An obvious simple measure would be harmonization of balancing to a standard daily balancing regime and within day information provided by all EU TSOs.*

**- 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.**

*A European-wide ITC scheme does not seem appropriate for the gas market for the foreseeable future. Work should focus on the priorities that we have set out..*

**- 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.**

*Transparency on information and clarity of the roles and responsibilities of the regulated entities (in this case primarily the TSOs) is the key a well understood investment climate, both for the network developer, the user of the network and the regulators themselves..*

### **The way forward**

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

*Regions should be based round the physical markets and good physical integration, ignoring national boundaries where appropriate. EFET has made suggestions in answer to an earlier question*

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

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

*Both physical and contractual congestion occur, but without more transparency the relative significance cannot be determined.*

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

*There is a need for more investment in capacity as the market grows, but in the short- term, gains can be made by ensuring that TSOs make all capacity available to the market to facilitate supply competition..*

**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)?

*Generally, regions should only be distinguished where there is semi-permanent physical congestion. As already realized by ERGEG (para 133) the practical way forward is to analyse what can be done to improve liquidity where gas is already being traded, and in other locations seek to remove the barriers that are preventing the development of traded markets.*

## Annex

### Additional Comment on Gas Quality

#### **Gas quality**

It is clear that “only net trading activity results in physical flows, so it is only physical but not contractual flows that may require treatment). It is important that gas quality treatment does not create barriers to trade” (127).

In responding to the questions raised by ERGEG in this section it is necessary to split the topic into two separate elements, namely: quality conversion (H to L Cal (or vice-versa), and gas quality generally relating to gas quality issues arising from the use of different sources of gas (including LNG) in one system.

In the case of the former, explicit facilities will be required to allow the conversion. These are likely to be have been sized to accommodate all necessary flows for a particular market. As such the market rules for use of the facilities should be such that long-term contracts do not prevent competing suppliers (for the same customers) being prevented from accessing the necessary services. Access to these services can be used by incumbents as a barrier to entry. As an alternative to UIOLI arrangements there could be discussion on whether it would be appropriate to deliver gas to a hub rather than the "city-gate" and then "deem" the conversion to occur by the relevant TSO.

Charges could therefore be levied on a throughput basis to ensure that costs fall ultimately to the customers needing the service. It is therefore likely that any investment decisions associated with this type of situation will need to involve the relevant system operators (Transmission and Distribution) who fully understand the load connected to the network in the relevant area, rather than relying on system users estimates of future demand.

For situations where there is a requirement for gas supplies to meet a system specification it should be the responsibility of the party providing that gas source to negotiate for the blending or treatment of such gas with service providers (which may or may not include the TSO). Where the issue is at a cross-border point it should be the responsibility of the TSOs to agree between them how to manage such requirements.

Whatever the location it is likely that greater information release regarding the potential capacity of blending services available combined with unbundling of TSOs (to prevent unfair allocation of services) would assist the problem.

As such the costs of the provision of the service should be market related (or subject to regulatory or competition authority oversight to ensure that charges are reasonable) and the same for all users of the same service. Again any investment decision will involve a wide range of parties TSOs, connected system operators, terminal operators (including LNG etc.) to ensure that timely and optimal investment decisions are taken.

It remains unclear whether or not all TSOs accept that it is their responsibility to maintain gas quality within their system as there have been attempts to make users of the system responsible even though the user has no control of the gas quality once it is in the system. **The TSO must remain responsible for managing the gas quality within its system under the national legislative and regulatory requirements.**