

**EXPERT GROUP FOR THE SETTING OF TARIFFS
FOR ACCESS TO GAS TRANSMISSION AND DISTRIBUTION NETWORKS**

CRE/MR/Q10 00-07

PRE-CONSULTATION QUESTIONNAIRE

Firms, organisations and persons consulted by the expert group for the setting of tariffs for access to gas transmission and distribution networks are, among others, to be invited to express their point of view on the following topics.

1. HOW DO YOU SEE THE EUROPEAN GAS MARKET IN TEN YEARS?

[The ten-year timeframe considered here is for purely indicative purposes. You are free to adopt a slightly longer or shorter period, if you would prefer to do so within the scope of a forecast approach. It is also acceptable for you to differentiate between the “desired” and the “probable”, or to speculate on more than one possibility. Quantification of scenarios is welcome]

1.1 The European institutional context

What, in your opinion, is the likelihood of the following scenarios?

A convergence of regulatory practices in Europe

We do not expect existing EU energy legislation to lead to a convergence of regulatory practices. A consistent approach to regulation of energy networks is essential if a single EU Energy Market is to be achieved. If there is to be effective convergence of practices, new rules are needed in the following areas - :

- *100% market opening for all member states*

- *Strengthening existing third party access rules*
- *Further unbundling of monopoly businesses from potentially competitive businesses*
- *A formal mechanism for co-ordination of cross-border issues*

“Eligibility” being extended to all consumers

The full benefits of liberalisation will only reach all customers when those customers (domestic as well as industrial & commercial) have real choices of energy suppliers.

While 100% eligibility is necessary for this, it is not sufficient to deliver competitive conditions. That is, the lack of real competition in the German electricity market shows what happens when a country opens a market without putting in place the mechanisms to deliver competition. Less than 2% of customers have switched supplier – over 2 years after the formal right to switch. In the UK, over 30% of customers have switched gas supplier while over 20% have switched electricity supplier.

EFET believes that it is possible to deliver 100% competition in 4 to 5 years. Thus, we believe it is feasible to envisage full retail competition by 2005 (earlier of course for the electricity market where we believe 2004 would be feasible). However, this will take several proactive steps from the CRE. For example, the setting up of the computer systems necessary to allow customers to switch easily can take two years.

Compulsory independent legal status for all “gas TSOs”

This is perhaps the most important element in securing a competitive gas market. Full legal, physical and financial separation is essential if a fully competitive market is to be established. If the network operators (including distribution companies) are properly separated, the network operators will not have an incentive to prevent the development of competition. Indeed, a separated network operator can be incentivised (by careful regulation) actively to promote competition. It is the experience of EFET that the dual role of network operator and network user is incompatible with non-discrimination in network access.

Compulsory unbundling at the institutional level of “distribution” and “supply” functions (what do you think of the alternative scenario of integrated distribution + supply concessions, possibly subject to tender procedures?)

In terms of delivering a competitive market, there is no difference between transmission and distribution – both are transport activities and natural monopolies. Therefore, separation of both transport activities from supply is necessary to achieve 100% liberalisation. The alternative model of supply concessions subject to tender processes has little merit other than for the construction of new distribution systems or as a transitional measure for low-pressure distribution networks serving only a small number of customers. At the end of the day, a tendering process does not lead to customers being able to choose their supplier.

Legal separation of storage installations

Non-discriminatory access to storage is essential for the operation of the liberalised gas market. Storage provides security of supply (particularly in France) and flexibility. Both of these are important to customers seeking alternative suppliers. Provided that the network operator is separated from the network users then monopoly storage facilities could remain with the network operator. Some internal unbundling of management and of accounts would be required for regulatory clarity since the role of a network operator and a storage operator are different. In the long run, we believe that there should be legal separation of storage.

Creation of Community-wide mechanisms relative to the supply and storage of gas

We assume that this is intended to refer to the suggestion of common gas stocks, thereby replicating that requirement in the oil industry. This idea is floated in the Commission’s Green paper on Security of Supply. EFET does not support putting in place artificial mechanisms, such as centralised gas stock management. However, there may be a role for some mechanisms to ease the transition from a monopoly to competitive scenarios. Emergency supplies of gas may fall into this category.

An expanding Europe. What are the consequences of this scenario?

As Europe expands then more of the transit routes will be within the EU (eg Poland) and the borders of the EU itself will move closer to the main production areas outside the EU. Enlargement would thus improve security of gas supply.

1.2. Gas dependence and supply

Taking into account the forecasts for growth in demand, in particular in the electricity generation sector:

Is the diversification of supply sources desirable in order to avoid the excessive concentration of the supply of gas?

Yes, as long as this diversification is not used to hinder the development of the tool that will deliver enhanced security of supply, namely full liberalisation. The focus should not only be in diversifying the sources but also to diversify the control of the source (e.g. supporting moves to end the Norwegian GFU selling cartel or the NAM / Gasunie single buyer arrangement.)

In this context of supply diversification, it seems strange that the Continental gas companies have chosen to link the gas markets to the oil market, and thereby the influence of OPEC.

Will concerns about security of supply constitute an obstacle to or an incentive for the integration of the European gas market?

EFET believes that concerns about security of supply will be used by some of the integrated Continental gas companies to hinder the development of competition. However, EFET believes that accelerated gas liberalisation will enhance security of supply. That is, liberalisation leads to

- *better physical integration of the EU gas market*
- *producers no longer being dependent on monopoly buyers, and producers being less able to command monopoly prices because the price will be determined by competitive gas-to-gas market forces*
- *construction of more storage facilities (although this may be less likely in France)*

To answer this question, we would urge the CRE to look at the liberalised markets of the US and UK. In those markets, competition increased security of supply through the development of more gas fields, more pipelines (including pipelines bringing gas from larger distances to market) and an increase in storage facilities.

1.4. Organisation of markets

Assuming that there were no obstacles of an institutional nature and that there were sufficient convergence of practices relative to access to networks and the setting of tariffs for their use (see *infra*), what, in your opinion, would be the general trends concerning the organisation of markets?

Operators: pursuit of capital-intensive concentrations? Vertical production/supply integration? What new entrants?

EFET believes that it is not wise to prescribe the number and type of companies that might evolve. However, the main types of company will emerge would include

- *Resource finders/exploiters (the producers)*
- *Network owners / operators (pipeline companies)*
- *Customer-oriented retailers*
- *Traders*
- *A variety of new entrant niche companies (such as www.buyenergyonline.com)*

What development of gas hubs? Who might be involved (big clients and, in particular, electricity producers)? Consequences for trading and for derivative markets?

It is difficult to force the development of trading hubs. We believe that-over the-counter trading can evolve into a series of hubs. Such a process will be accelerated by the presence of a fully independent system operator and many competing gas suppliers. All types of companies involved in gas purchase or sales are likely to participate in a traded gas market, in addition to specialist trading companies.

Evolution of hubs is important in the context of security of supply. The price transparency revealed at a trading hub will allow gas companies to mitigate risk as the role of derivatives grows. In liberalised gas markets, it is already the case that long-term investments have been financed by the use of innovative financial tools – rather than the long term take or pay contracts that have traditionally been used to mitigate risk.

Creation of real gas-gas competition, leading to the disappearance of indexing clauses for competing types of energy or even the abandoning of the dollar reference?

In a free market, participants may choose to buy or sell gas on whatever terms they wish. However, there can be a very strong expectation that as soon as efficient gas markets are established they become the main reference points for pricing both long-term and short-term gas deals. This implies that gas indices will become less and less tied to the oil industry (and thus OPEC) and more related to the actual costs of gas.

Shortening of the term of contracts? Relaxing or even the disappearance of “take or pay” clauses? Management of the transition (impact of contracts currently in effect)

One common feature of the move from a monopoly to a liberalised market is the reduction in the term of contracts. While long-term contracts still have a role in a liberalised market, there will undoubtedly be a wider variety of contract forms and contract durations than in a monopoly situation.

The period of transition from a monopoly to a competitive market can be difficult. It can involve the restructuring of the existing long-term contracts. This could involve some form of gas release programme, thereby easing the transition as well as stimulating competition.

Is the swapping of customers between operators and the cross-border flows sufficiently intense for it to be genuinely considered that a truly integrated European gas market has come into existence? If this is still not the case at the end of the period in question (2010), will the market be progressing towards this integration?

It is absolutely clear that a “truly integrated European gas market” has not come into existence. Whilst a large volume of gas crosses national borders

within the EU, this gas is not freely traded. The Gas Directive has not been sufficient to give a clear and explicit right of access to these transit lines for all network users. Until this is achieved there cannot be said to be a truly integrated EU gas market.

In EFET's view, under the terms of the current Gas Directive, such integration will not occur. The role of regulatory or competition authority is paramount in this development. It is incumbent upon member states to put in place the correct rules and market structure to ensure full liberalisation. Member states that choose not to be proactive will end up with higher prices than their neighbouring countries.

It is the view of EFET that full liberalisation in the gas sector can be delivered in 4 to 5 years – 2005 seems to be reasonable date. In order to achieve this date, it needs a pro-active, expert regulator. Systems development will be an important part of delivering 100% liberalisation.

2. WHAT TARIFFS FOR ACCESS TO NETWORKS FOR AN INTEGRATED EUROPEAN GAS SYSTEM?

The organisation and operation of markets, the procedures for the management of physical flows by TSOs and the setting of tariffs for access to infrastructures are closely connected matters. This section examines what provisions applying to the management of networks and to the setting of tariffs for access to infrastructures most favour the development of an integrated European gas market, always within the scope of long-term consideration over 10 years, or even longer.

2.1. Operation of markets and management of physical flows

2.2.1. Aspects of short-term operation

In the event that the aim is to encourage, to the maximum extent, the fluidity of transactions between players in the gas sector (producers, importers, suppliers, traders, consumers) and if, in the context analysed above, short-term transactions within the framework of structured

markets (gas hubs) or bilateral agreements were to increase significantly:

Comment

This part is a series of detailed question about how to operate a system in real time. While we have answered each question individually, we have a more general comment. Putting together each of these answers and you have the beginnings of an access code. It is this code, how it is drafted, and how it can be modified that will form the centrepiece of any access regime. There is an increasing amount of experience of developing network codes and we suggest that CRE looks to the areas covered by existing access codes when considering the individual answers to these questions. EFET is happy to provide a detailed list of the type of issues that should be covered in an access code if that would be helpful.

On the basis of what information should TSOs arrange the management of physical flows in the networks? Should they endeavour to monitor transactions themselves or limit themselves to recording their consequences through physical injection and uptake forecasts provided by operators?

We understand this to be a question about the information upon which network operators run the system. Any attempt to follow contracts will fail, as well as hindering the development of competition. However, network operators should have a right to physical information about the operation of the system. This can be achieved through nominations of likely physical flows (at each exit and entry point), rather than a list of each contract position taken by parties.

In order for the system to remain manageable, what constraints would have to be imposed on market managers? On operators?

This is impossible to answer without knowledge of GdF's system – in particular the flexibility of the system – “linepack”. A general principle would be that all parties (including the marketing affiliate of GdF) should be treated in the same way.

How should network managers obtain and implement the adjustment resources needed for the proper control of flows in the networks?

We understand this question to be about flexibility. Network operators can provide these adjustment resources themselves, eg, through the use of storage, linepack and interruptible customers. Alternatively, the resources needed for adjustment purposes can be obtained through a balancing market. However, this will only be possible if there is sufficiently robust access to the transportation system.

What mechanisms should be put in place to manage possible congestion? Should long-term contracts be given precedence over short-term exchanges? Should bidding systems figure? If yes, would this involve reserving transmission capacity or buying injection or uptake rights?

Generally, competition should not produce new examples of congestion as the same gas will tend to remain flowing to the same customers. Where congestion does arise, it is possible for market mechanisms to be put in place to manage congestion. This could involve some form of capacity reservation – either by trading parties, or by the market operator. Alternatively, the network manager could be allowed to re-order gas flows in order to remove constraints. Any congestion fees (under the first proposal) or costs (under the second proposal) would need to be ringfenced.

In principle, long-term contracts need not be given priority. Indeed, where a customer has changed supplier, this would imply that there should be some form of capacity transfer from the existing long term contract to allow that change of supplier. As for contract length, this should be up to the customer. EFET members are finding that customers switching supplier for the first time want shorter rather than longer energy supply contracts.

With regard to “cross-border” transit¹, on what basis should the co-operation of TSOs be arranged (“one-stop shop”)?

The network operators have been co-operating on cross-border transit for years. In that time, customers have used a “one-stop shop”, even if the gas has been sourced from abroad. In that light, there is no reason to propose a change to this system of TSOs managing physical cross-border flows. However, in a competitive market, there will be new roles for shippers,

¹ This refers here to borders between the areas of authority of TSOs

allocation agents etc. Some of the existing cross-border agreements / arrangements will need to be unbundled to allocate these responsibilities accordingly.

In setting up balancing, adjustment and modulation markets, what is the expected contribution of the following, respectively:

- **underground storage facilities (after taking into account, where applicable, any mutualisation of security reserves at a European scale)**
- **interruptible customers, in particular power stations**
- **bidding mechanisms for energy “hubs”, including electricity/gas hedging**

All of these instruments are important in a balancing market. The importance of each should not be defined in advance. Rather, concentration should be applied to creating an efficient balancing market.

Do you view access to storage capacity as a condition for fair competition? If yes, in what form (third-party access to stores, negotiated access to stores, bidding, etc)?

Access to storage is necessary for fair competition. It is particularly important for the development of competition for smaller users. Small users do not have the resources to monitor their gas use closely and purchase gas in fixed increments from a variety of suppliers. Rather, they demand “full requirements” service, which places the obligation on the supplier to meet an often unpredictable and fluctuating load.

In principle storage could be competitive. As a minimum, non-discriminatory regulated access should be provided. However, storage is a potentially competitive activity and this should be an early focus of the CRE.

2.1.2. Aspects of medium- and long-term operation

Foreseeable development of gas infrastructures (transport, storage, regasification) with a view to guaranteeing considerable physical flows for transmission and exchange

With the creation of independent TSOs, transport, storage, regasification will be developed through competitive forces to satisfy security of supply.

What are the risks of bottlenecking (permanent transport congestion, insufficient storage capacity, etc.)?

Bottlenecks can be temporary. Competitive forces, independent TSOs and correct bidding structures will allow the alleviation of congestion.

Capacity of independent TSOs to decide on new cross-border infrastructures and provide finance thereof

A single European gas market structure with independent network operators and a strengthening of third party access conditions will allow for market competitive forces to signal to network operators the level and need for new cross border infrastructure.

Can the appearance of true competition with historical operators be envisaged in the development of transport, regasification and storage infrastructures, and if so by what date?

In theory, development of competition in transport, regasification and storage is possible. However, in terms of priority, we suggest that CRE concentrates on the delivering access to regasification (since this will lead to freeing up gas) and access to storage (since this will free up flexibility. EFET considers that competition in these areas is more important than developing pipe-to-pipe competition.

2.2. Organisation of markets and setting of tariffs for access to networks

Comment

All the principles stated below are crucial to ensure a fair and correct setting of transportation tariffs. A tariff structure should

- *Be transparent, non-discriminatory and reflect costs*
- *Make possible the proper operation of markets and networks*
- *Direct the investment decisions of network operators by means of the relevant “long-term signals”*
- *Ensure that network costs are covered*

2.2.1. Encouraging the “proper operation” of markets

Taking into consideration your long-term vision for the state of the European gas market over 10-15 years, and in particular your prognosis on the increase in short-term transactions centred around gas hubs, what, in your opinion, would be the most suitable principles to be applied in price-setting? Should the tariffs apply to the flows passing over the networks or to injections and uptakes? In each case, should each cubic metre in transit, injected or taken up be “charged”, or should any such charge apply to the transit, injection or uptake capacities reserved (or both, and according to what logic)? Should the “distance” figure in the setting of tariffs, and if so how? And should the effects of structural congestion be translated into the tariffs, or should they be dealt with systematically using bidding mechanisms and/or reserved capacity market mechanisms?

The most important principles for the design and level of transportation tariffs are that they a) facilitate the development of competition and b) are the minimum charges necessary to ensure that the system owner/operator has sufficient incentive to continue to provide an efficiently run network to satisfy all reasonable demands for gas transportation. These principles can be implemented in several different ways, but in practice the method of charging will need to be a compromise between cost reflectivity and simplicity.

While distance is one factor that affects the overall costs that a network operator incurs, the use of distance-related point-to-point transportation tariffs are unlikely to reflect the true overall costs. The administrative complexity that they introduce is well known to act as a barrier to the development of competition.

Regarding pipeline capacities, the key principle is that all unused capacity, whether or not it has been booked by other shippers, must be available to system users that needs it on the day.

2.2.2. Giving the relevant “long-term signals”

Who should these signals be aimed at? What forms should they take in order to be effective, while not interfering with short to medium-term market mechanisms?

Once traded markets develop for gas, for capacity, for storage etc., the future values of gas, of capacity and of flexibility will be established by the market.

This implies that long-term bookings of capacity and storage will take place and that market prices will exist for long-term deals. In the transition to a fully traded market the CRE must ensure that the charges levied on shippers reflect the Long Run Marginal Costs of those parts of the network that will need future investment. Publication of the network operator's development plans and forecast capital expenditure as part of ongoing consultation with network users is an essential part of this process.

2.2.3. "Covering network costs"

What meaning, in your opinion, attaches to this very vague expression? In relation, in particular, to capital charges, on what basis should they be calculated? Should a regulatory level of profitability be considered? Would it not be more relevant to look into the financing capabilities of network operators, taking desirable investments into account?

There has been a vast body of work in this area. Most recently, the European Commission asked The Brattle Group to undertake a study on this, and other subjects. In summary, the profits or revenues of network operators should be related to some form of regulator-defined level of revenue or profitability, but with some form of check that this does not require the network operator to raise too little money, or allow the network operator to raise too much money.

2.3. Setting of tariffs for networks and European integration

In the event that the European market should continue to appear as a juxtaposition of subsidiary markets, each with its own tariff system, what minimum degree of harmonisation do you consider indispensable in order to allow the truly competitive integration of the Community, or even the European, gas sector? How should exchanges between sub-systems be priced?

The network user must have immediate access to the information needed to enable them to provide a quote to a customer and to know that the transportation system operators will move the gas as needed by the supplier. There should not necessarily be any charge for crossing a national boundary or crossing from one system to another. Charges must facilitate the development and maintenance of the competitive market whilst being broadly cost-reflective of the service that is provided. The charges for sub-systems should be developed bearing in mind that gas will flow between the subsystems. If the charges for using each individual

system are only cost reflective when each system is used in isolation then this will lead to pancaking and/or simply over-charging compared with optimal grid operation.

3. WHAT DO YOU THINK OF THE PROVISIONAL TARIFF SYSTEM THAT HAS BEEN IMPLEMENTED IN OUR COUNTRY?

Your assessment should differentiate between:

The principles:

The principles surrounding a tariff system should include the following:

- *Costs reflectivity*
- *Non-discrimination, both in terms of access terms and conditions and rates*
- *Transparency*
- *Promotion of competition*

Entities concerned: eligible customers, suppliers, other gas operators, traders, etc.

Suppliers other than GdF are being discriminated against. Entry for new participants is limited in practice to one injection point (Taisnières H). It has not been demonstrated that the charges for new entrants are the same as those offered by GdF for its own, potentially eligible, customers.

Service offered:

Firm / interruptible

Only firm capacity contracts are available for shippers. As explained above, interruptible customers are an important part of a flexibility market. Even the capacity offered is not totally firm. That is, GdF reserves the right to cease transportation in case of force majeure. While this is reasonable contractual term, it is not reasonable that GdF continues to require payments on the capacity payments even in this event. Thus third parties remain at risk for the capacity. Currently, the only way to limit that risk is to contract in parallel of a transport contract, a transport to storage and storage contracts with GdF. Also, planned maintenance at the end user's site or in the GdF system should - but does not - trigger a reduction in the

transportation cost charged to the shipper. In sum, the firm service is not an economically viable service for third party shippers.

Transferability of rights

The current system is similar to a point-to-point service. The transferability of rights to another player is impossible. Trading cannot thrive in such an environment. The ability efficiently to trade capacity rights is an important part of a competitive market.

nature: transport, distribution, regasification, modulation (storage), etc.

Transport and Distribution:

Although prices have been published for all entry points, only one is actually available in practice. Thus, for the majority of customers in France, the transportation tariffs will not be cost reflective if they elect to change supplier. In addition, distribution tariffs should be published and transparent. Today, third party suppliers must contact GdF with the customers site address in order to find out distribution costs. This is not an efficient system of third party access.

Regasification (LNG):

Access conditions at the LNG terminals have yet to be published and it is not clear whether or not TPA is allowed. TPA should be allowed and regulated to ensure a fair, non-discriminatory access to gas, as well as the network. It is the LNG terminals (together with the existing entry points) that will allow competitive gas to be delivered into France.

Contrat de modulation (balancing):

The importance of balancing services is to enable the network operator to maintain system wide integrity. However, shippers should be entitled to decide for themselves how to provide such balancing services. This must be allowed on an aggregate, not a site-specific basis. Linepack should also be offered as a balancing mechanism. Finally, any revenues or costs raised by the network operator for providing balancing charges (or any other services) should be shared by system users.

Storage:

There are no storage services offered by GdF apart from the use of storage for balancing purposes (Contrats de Modulation). The ability to access storage represents one of the most significant sources of competitive advantage for a supplier of natural gas. It lowers its costs, facilitates balancing, and allows it to provide greater flexibility and security of supply to its customers. Storage is essential for balancing and arbitrage purposes and therefore should also be offered as a stand-alone service. Storage should be offered to all market player with out them necessarily having end use customers.

3.2 Implementation methods:**Term of contracts**

GdF transportation contracts are currently only possible for terms of one year. This provides for a lack of flexibility for customers and shippers to adjust for monthly fluctuations. Transportation contracts should at least be allowed for periods of one month, even if at a slight premium. Shorter-term contracts will allow shippers, traders and customers arbitrage opportunities and allow them to efficiently optimise their supply requirements.

Network access code

A network access code needs to be put in place for entry at all injection points in France. Access capacity needs to be published at all points. As explained above, the mechanism by which this code is put in place is important. It should involve discussion with all market parties. It is also useful to introduce a mechanism by which all parties to the code, as well as other interested parties such as customers, are able to discuss changes to the code. There should also be the ability to bring disputes to the CRE.

Tariff structure (fixed components – capacity; variable – quantities)

The current structure for GdF tariffs is 80/20. We do not have enough cost information to determine whether or not these are cost reflective.

Geographic gradients

Again, without access to costs, it is difficult to comment on the numbers put forward by GdF and the other network operators. In principle, it makes sense to reflect a geographical difference in costs. However, in the early days of

liberalisation, it is more appropriate to have a relatively simple structure of charges. A postage stamp structure could be appropriate and would facilitate trading.

Balancing system (daily and cumulative)

The tolerance bands that GdF proposes (daily levels of 20% for consumption under 1000 MWh/day, 5 % for consumption superior to 1000 MWh, and monthly levels of 3%) seem to be reasonable. However, the penalties associated are too high. Furthermore, the tools given in the GdF (“Contrat de Modulation”) tariffs to adjust supply to match consumption are restrictive.

3.3 Resulting tariff levels:

- **for different categories of eligible customer**

The limited practical access to one interconnector creates hugely discriminatory rates for customers at a distance from that entry point. Thus, only a very limited number of eligible customers are able to benefit from alternate suppliers. Furthermore, the marketing affiliate of GdF benefits by not being limited to one injection point.

- **in relation to neighbouring countries**

Transportation tariffs seem to be in line with the rest of the European countries. However, GdF’s balancing penalties and balancing service do not seem reasonable when compared to the rest of Europe (based on the European Commission report delivered at the 3rd meeting of the gas regulatory forum in Madrid).

- **how to define and verify the absence of cross-subsidies between captive customers and eligible customers?**

We do not have access to the cost information on the French gas infrastructure to be able to provide comments on this subject.

3.4. The initial “returns from experience”

It currently is practically impossible to sign up a customer. There are several reasons for this –

- *Even for a flat consumption, under a force majeure or planned outage by GdF, the lack of back up services offered by GdF make it*

uneconomical for a third party shipper offer service. Under current conditions, the only way to guarantee supply, third party suppliers must contract for storage and associated transport for one year to cover a relatively short planned outage.

- Liability is limited to 1/6th of the contract value by either party that defaults. If congestion and/or outages on the GdF system force you to default on a one-year contract after, say, two months, you are at risk for eight of the ten remaining months.*
- Trading is very limited, thus arbitrage opportunities, liquidity of the market are limited and cannot provide for mechanisms that optimise delivery for different customers.*
- Access is s limited in practice to only one entry point. The other injection points in France are effectively closed to third parties. This limits the number of customers that can expect offers form third parties. It limits shippers' abilities to diversify their sources of supplies.*
- Storage is not available as a stand-alone service again limiting customers' flexibility to match their unpredictable consumption patterns.*
- The minimum contract length is one year again limiting flexibility*
- Balancing services (Contract de Modulation) do not allow for sufficient flexibility. Storage assets and associated transport contract are the only resource available for balancing purposes. Linepack should be used as a balancing resource.*
- Some customers wishing to change suppliers are told that they do not have the historical consumption to reach the eligibility criteria even though they would on a forward-looking basis. This did lead in the UK to customers burning gas to reach the eligibility threshold.*

4. WHAT, IN YOUR OPINION, ARE THE DESIRABLE CHANGES IN THE SHORT / MEDIUM TERM?

Aside from the issues relating to tariffs, you may mention their environment: the structure of markets, role of TSOs, principles and method of regulation, new entrants and change in historical operators, etc.

4.1. At EU level

Make a distinction, as far as is possible, among Community initiatives, co-operation between regulators, between TSOs, the play of “market forces”, etc.

It must be the role of the European member states (via the European Commission) to put in place a competitive framework. As the answers to this questionnaire show, EFET believes that the present Gas Directive will not allow a fully competitive market to develop. At the liberalisation seminar held by the European Commission on 14 September 2000, EFET put forward its views as to what should be in any amendments to the existing Gas Directive. We have attached this paper. The views can be summarised as –

- *100% market opening (2004 for electricity, 2005 for gas)*
- *Strengthening third party access (via unbundling, defining access to the system for all users, access to all services and greater information), and*
- *Addressing cross border issues (including inter-operability issues, congestion management etc)*

4.2. At the national level

Make a distinction between the respective provinces of lawmakers, the future CREG (Regulatory Commission for Electricity and Gas) the play of “market forces”

Assuming that a competitive framework can be agreed at the EU level, the CRE should undertake a competitive analysis – that is, are all elements of the gas chain open to competitive forces? The aim should be to identify those areas that could be open to competition. It would include analysis of

- *Access to gas*
- *The supply market*
- *Access to flexibility*

4.3. At the European level, in the broad sense

Relationships between players outside the EU and the Community market, future of large projects (Iran, Azerbaïdjan, etc....)

Competition authorities should look at competitive mechanisms to introduce new sources of gas in Europe. New players will create more flexible contracts. Financial markets can provide capital, but only if the downstream market is competitive.

EFET does not believe that incumbent and integrated (and dominant) gas companies should only be allowed to sign new long-term contracts if there is full separation of monopoly activities. If separation is not achieved, then customers will end up taking the risk of these contracts and not, as in a normal competitive market, energy companies.

EFET POSITION PAPER

Acceleration and deepening of liberalisation of energy markets in Europe - necessary provisions for a new Energy Directive

14 September, 2000

secretariat@efet.org

Acceleration and deepening of liberalisation of energy markets in Europe – necessary provisions for a new Energy Directive

The European Commission has been set the task, by Member States, of producing a plan for the accelerated liberalisation of the gas and electricity markets in Europe. It seems likely that a new Energy Directive would be part of this plan. This paper sets out some fundamental provisions which EFET believes should be covered in a new Energy Directive so that liberalisation can be truly effective. We assume that any such legislation would be brought forward as a series of amendments to the 1997 and 1998 Electricity and Gas Directives. However, we have not attempted at this stage to describe the precise location nor wording of any amendments.

1. Market opening

Many countries now have plans for full market opening. Recent government announcements have been made about proposals for the acceleration of gas and electricity market opening in Austria, Belgium, the Netherlands and Spain. Some countries have not come up with any plans to accelerate full market opening, namely France, Italy, Portugal and Greece. A future Directive should call for full market opening by a date certain even if setting that date requires the granting of minor derogations. A case for distinguishing the timetables as between gas and electricity could be made because gas liberalisation has started later, not because it is more difficult. So it may be reasonable to mandate full **electricity** market opening **by 2004**, and full **gas** market opening **by 2005**. Another alternative would be to set a later date for domestic customers, although this does raise problems with definitions.

There are many necessary conditions for a successful competitive energy market. Two important aspects would be capacity release programmes (thereby starting to address market dominance) and effective systems for allowing the easy transfer of customers between competing suppliers. However, the most important condition is successful TPA.

2. Strengthening Third Party Access (TPA)

The Directives allow Member States to choose their access regimes. Most countries have chosen RTPA (Regulated Third Party Access), as opposed to Negotiated Third Party Access (NTPA). Experience in liberalised markets demonstrates that securing access to networks and related services can require significant regulatory input. Even in Germany, which has opted for NTPA in both gas and electricity, the Cartel Office has been considering an

increasing number of cases. Experience also shows that an NTPA system is likely to evolve into an RTPA system, as regulatory decisions make precedent. On that basis, it would seem to make sense for the Commission to provide more guidance on the form of access. Such guidance should, at a minimum, include rules on the issues identified under succeeding headings of this section 2.

a) Unbundling

The Electricity Directive requires managerial separation of the monopoly businesses from potentially competitive businesses. The Gas Directive requires accounting separation only. Experience from other liberalised markets highlights the importance of significant separation of monopoly activities from potentially competitive activities. Unbundling can help prevent discrimination against third parties in favour of affiliates and abuse of dominant position by a vertically integrated incumbent. It can also facilitate cost-transparency and regulatory intervention in case any of these problems arise. Finally, a suitably separated, and incentivised transport system operator can relieve regulatory burdens.

For the separation of activities to be truly effective and verifiable, we advocate separation beyond solely accounts unbundling and separation of management and information, to require physical, legal and financial separation of affiliate entities. Physical, legal and financial unbundling would imply separation of management structures, staff (including their career development), assets and liabilities, cash and debt management, information systems and buildings. Such separation also has relevance for the lower tiers of the transport network, generally known as distribution systems.

Looking at the experience with the Electricity Directive to date, there have been allegations that access to the network has been hindered due to the integrated nature of the companies offering system access. Also, there are instances, in several countries, of applications for access to the system resulting in the supply affiliate of the transportation business making competing offers to customers, implying a leakage of information between businesses.

We believe that all this points towards further unbundling than is currently included in the Gas and Electricity Directives. As argued above, we believe that the amended Directives should require physical, legal and financial separation. We also think that the standard for management unbundling in gas should be brought up to that in electricity. Stricter unbundling should be accompanied by a requirement that Member States introduce effective monitoring and enforcement measures, so that it is achieved in reality.

b) Access to the system for all contracting parties

Successfully liberalised markets demonstrate a wide range of parties that need access to the system - suppliers, distribution companies, shippers, traders and end users being five distinct groups. The implication of 100% eligibility is that there would no longer be a need to define 'eligible customers.' As such, access to the system should be guaranteed under the new Energy Directive for all users and potential users of the system, subject of course to any reasonable licensing requirements. An example of this broad definition can be found in the Danish Electricity Supply Act. Users of the system was defined to include those companies that use the system for transportation of electricity only, for example companies that trade in electricity, (as well as customers and generators). Another successful example of dealing with this problem can be found in the existing German legislation, which gives broad rights of access without any such listing or any definitions at all. Such provisions and their application have reinforced the successful opening of the wholesale German power market.

A similar broad definition in the text of the Directive would exclude the possibility of discrimination against wholesale intermediaries. There is, of course, an alternative solution, which would entail exhaustive listing out of the categories of possible users of the system, but this appears unnecessarily cumbersome

c) Access to all services on like terms

The existing Directives call for non-discriminatory access to the transmission system. In both gas and electricity, access to transportation capacity is a necessary, but not a sufficient, condition for ensuring efficient, liquid and truly competitive markets. Thus, the availability of appropriate, economic balancing services from a network operator is an example of a highly important service to new market entrants. The necessity of third parties being able to contract for such a service has been recognised by the Commission in electricity (in the form of a concession in a merger case) and in gas. Access to storage, for example, is crucial for the gas sector and denial of such a service to a market participant would virtually prevent it from exercising its right to supply gas to customers.

d) Information

It is difficult to over-estimate the importance to suppliers of information about the monopoly transportation networks. Such information includes capacity availability, prices, terms and conditions for access and network maps. The Commission could specify the information which Member States should require network operators to divulge. A starting point would be

the information that the Commission has identified by published by the TSOs as part of the Florence and, we hope, the Madrid processes.

3. Cross-border issues

Creating a single European market for energy requires resolving access to networks within countries, as well as access to cross-border capacity. The Florence and Madrid processes have been used as a way of addressing these cross-border issues. However, it may be time that the valuable work of the Florence and Madrid processes are codified into a new Directive. Areas to be included would be -

a) Obligations for Transmission System Operators (TSOs)

We believe that the new Directive should include guidelines for the Member States on the obligations they should impose on their TSOs. Such guidelines should necessitate that the TSOs duly publish their available transfer capacity so that this information is accessible by all users of the system. Such guidelines should include measures that would encourage TSOs to use market based methods for increasing available capacity (through methods such as counter-trading or redispatch) and for allocating this capacity to all users on a non-discriminatory basis (via market splitting, implicit auctions based on commodity price, or auctioning of the capacity). These guidelines should certainly, whatever the methodology, require the application of the 'use-it-or-lose-it' principle in capacity allocation. Grandfathering of capacity reservation by TSOs for their affiliates should be forbidden, wherever the corresponding long-term commodity contract has not been explicitly approved by DG Competition. Also, where such capacity is reserved, it must be on the basis of the existing commodity contract, not a subsequently renegotiated version.

b) Congestion management

Physical upgrades to the existing cross-border transmission capacities are not necessarily the only solution to congestion problems. Market-based mechanisms, offering a more efficient utilisation of the capacity effectively available at present, often represent a viable alternative to the construction of a new capacity, especially if temporary market disparities or distortions may be overcome and dominant flows then change. To realise this potential, TSOs should manage existing interconnectors in such a way as to minimise inter-transmission system constraints. To achieve this, regulators may need powers to incentivise the TSOs and oblige them to co-operate with each other (see section above).

c) Interoperability issues

The introduction of competition in the electricity market has changed the flows of power between countries. In gas, the majority of gas consumed, even in unliberalised state of continental markets, has crossed a border, implying that issues of interoperability have been overcome. In this light therefore, there should be a requirement to explain how cross-border issues should be overcome. Another idea would be to require TSOs to develop, with interested parties, standard trading contracts at major trading locations.

d) Transit

Eligible customers already have the right to seek transmission access within a country in order to seek competitive supplies. However, not every Member State extends this right of transmission access explicitly to capacity used for transit (i.e. taking power or gas across a country's grid, rather than producing it or delivering it in that country). Before the energy Directives were adopted, there were the Transit Directives. These gave high voltage grid operators and gas pipeline operators the ability to transport electricity and gas transacted between themselves across each other's systems. A future Directive could repeal the Transit Directive, substituting a mandated explicit right of all third parties to have non-discriminatory access to grids for transit purposes.

e) Cross-border charges

Cross-border charges on the EU level have not been addressed in gas yet. In electricity, the Florence forum sessions have created a framework for discussions on the principles of transmission tariffication on a pan-European level. The consensus achieved at the recent Florence session in March 2000 has been against any transaction-based tariffs and against any charges to be imposed on import or exports solely. We believe that there must be some provisions in a new Directive on the principles of a system of non-discriminatory, cost-reflective and transparent tariffs across borders even if the precise mechanisms of charging are left to subsidiarity.

Summary

EFET welcomes the Commission's proposals to accelerate the pace of liberalisation. The issues discussed above demonstrate that merely mandating 100% eligibility will not, in itself, deliver to customers the benefits of competition. Rather, the Commission must, as far as possible, deliver third party access, in practice, rather than theory. The Florence and Madrid processes still have much important work to do.