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GIE Response to ERGEG Roadmap Consultation

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1. Executive Summary

It is a good time to take stock of where we are and reflect on the progress made in the drive towards a single European gas market. Much has been done, but there is still much to do. It is important to now put in place a holistic plan with tangible milestones to reach the objective. The combination of this plan and a series of regional initiatives to identify and resolve pragmatic issues represent a good way forward and GIE is keen to play a full and active role.

In accordance with the conclusions of the recent Energy and Telecommunications Council meeting, GIE is strongly convinced that the right balance needs to be found among the three objectives - competitive markets, security of supply and environmental compatibility, taking into account national circumstances. In terms of the Roadmap, it is of vital importance that both the security of supply and national dimension are not forgotten, whilst not frustrating the development of the market.

From an infrastructure perspective, we consider that the establishment of a stable and predictable investment climate is of the utmost importance. The gas market is becoming more global, less predictable and imports into Europe are increasing. This requires increased flexibility and capacity from gas infrastructure, creating the need for a huge investment in infrastructure. Gas infrastructure assets are capital intensive and typically have technical lives in excess of 40 years. Historically these assets have been funded through long term contracts. With short term trading increasing and the growing flexibility in supply routes, this traditional model is being challenged. Long-term contracts will remain the cornerstone of future investment, but this new dimension needs to be addressed. It is therefore essential that a stable regulatory framework and a sound investment climate be established to cater for the traditional contracting model and to respond to the evolving market situation. A key aspect of this, particularly for non-domestic investment, will be the co-operation between regulators and ensuring consistency of regulatory decisions.

We believe, in contrast to the Roadmap consultation, that we do not need further legislation to deliver the single European gas market. However, we now need to push for full implementation of the Directives and Regulations, combined with the use of voluntary guidelines which are key to the achievement of the single European gas market. Compliance, with these agreements and legislation, needs to be monitored and where a lack of compliance is identified this needs to be investigated and rectified. If all market players and regulators play their role according to the provisions in place, a genuinely competitive European gas market will emerge.

2. Introductory comments

GIE welcomes the publication of ERGEG's discussion paper on "Roadmap for a competitive single gas market in Europe". We believe that this is an important and timely initiative that will provide a clear direction for the future, focussing on key issues that will make a genuine difference. The visibility brought about by the Roadmap should provide a stable and predictable regulatory agenda,

which is of high importance to infrastructure operators. It is also encouraging that the consultation adopts a holistic approach to the issue, considering for example both supply and infrastructure, as without this view progress at best will be patchy and disappointing. The role of infrastructure operators is to make sufficient capacity available and to provide transparent and non-discriminatory access to this capacity, thereby facilitating competition and contributing to security of supply. To supply the market with sufficient gas in order to create a competitive and liquid market is a role that lies with other market parties like commodity and upstream players.

The 2004 Security of Supply Directive (2004/67/EC) is recognition of the need to ensure that through the process of liberalisation the high level of security of supply (SOS) delivered by the gas industry is maintained into the future. This fundamental issue was re-confirmed by the recent EU Council meeting where it was stated that the requirements of competition must be balanced against the need for SOS. We believe more attention to this point should be given in the Roadmap and it should be an integral part of the regional initiatives.

We recognise that much still needs to be done in fully implementing the measures in place to provide the conditions for a genuine single European market. However, we believe it is a good opportunity to reflect also on what has been achieved since the 2002 strategy paper was presented to the Madrid Joint Working Group. Immense progress has been made and the majority of the concepts discussed in 2002 are now common practice for example: entry-exit systems for domestic markets, secondary capacity markets and Use-it-or-lose-it (UIOLI). The progress made has been the result of the whole gas industry working together, a key and successful aspect of which has been the work of the Madrid Forum. The Madrid Forum provides the platform to progress in a common manner the further detailing of the market rules. This Forum was responsible for the development of the Guidelines for Good Practice for transmission and storage access. Through the use of these voluntary practices it has been possible to facilitate the liberalisation process in a timely, consistent and successful manner.

3. Regional initiatives

GIE supports the creation of regional initiatives, as a way of quickly and pragmatically addressing possible barriers to cross border trade and increased hub liquidity. However we believe that it is extremely important that the regions are appropriately defined in-line with this stated objective. We consider that the larger the region, the greater the difficulty to make tangible progress. Also combining countries that have very different structures, for example a mature market with a fast growing market is likely to lead to sub-optimal results. We believe that by defining regions that are relatively homogenous and manageable in size the quickest progress would be made. Potential regions could be for example a fast growing region, a mature region or a region with significant transit flows.

To enable the further integration of the single European gas market, we would urge ERGEG and the Regional Steering Committees to prioritise the work of the initiatives. From our perspective, in the first instance the initiatives should concentrate on establishing the right conditions for the necessary investments between hubs.

With regard to the governance of the regional initiatives, GIE believes that the Steering Committees should not only consist of the regulators from the Member States in the region, but should also have industry representation and in particular from infrastructure operators. It is also important at the start of the process to determine the scope and nature of any decisions to be taken by the Steering Committee and how this fits into the overall policy framework. GIE and its members welcome the opportunity to play an active role in the development and delivery of the regional initiatives.

4. Effective network access

Consistent with the second Gas Directive and the Gas Regulation on Transmission Access, it is essential that users have non-discriminatory and transparent access to infrastructure. These are the

measures against which infrastructure operators should be assessed. The way in which each country, national regulatory authority and infrastructure operator delivers this objective will vary depending upon the market structure and type of infrastructure, as allowed for under the legislative framework.

With regard to transparent and non-discriminatory access, the Guidelines for Good Practice on transmission and storage access and the adopted Gas Regulation provide a comprehensive set of requirements for the products to be provided and the conditions under which the products must be offered. Many infrastructure operators have already fully implemented these requirements, including the instruments to alleviate contractual congestion i.e. the development of secondary capacity markets, the application of UIOLI and ensuring that the maximum technical capacity is offered to the market. The requirements contained within the Gas Regulation become legally binding on the 1 July 2006.

It is also important that infrastructure operators publish the data that the market needs and protects data that is of a commercially sensitive matter. For both transmission and storage, the existing voluntary guidelines cover these issues and in the case of transmission these requirements are also contained within the Gas Regulation. We believe that the necessary measures have been put in place that will ensure that data is published and protected in an appropriate manner.

We now need to give all of these measures time to work and to monitor their effectiveness. As the market evolves GIE in co-operation with the Madrid parties will seek to further develop the rules on a voluntary basis to ensure that they remain in-line with market requirements.

5. Establishment of hubs

We are currently experiencing a consistent increase in the number of hub locations and in the amounts of gas traded. In 2004 the gas consumption of the European Union was about 570 billion m³ and we estimate that about the same volume of gas 550 billion m³¹ is currently traded on European hubs per annum. The first hub was the National Balancing Point, which was formed in the mid 1990s for mostly balancing reasons. This is still the dominant hub in Europe, as far as volumes are concerned. In 1999, the Zeebrugge hub was developed, this was followed by the development of many other hubs including, the Dutch Title Transfer Facility (TTF), trading activities at Baumgarten, the Italian PSV, the French hub zones (PEG), the Eurohub, the Danish GTF and the BEB Virtual Point (VP). The most recent development, in late 2005, was the launch of the MTS-ATR trading platform by Enagas. Trading on an OTC basis, within the Spanish system, had taken place since 2002.

There are many benefits of hubs, including facilitating trading, enabling balancing and managing interruptions / supply constraints. In addition they provide a degree of price transparency, a price reference point and the possibility of hedging. It is evident that hubs play a key role in the market liberalisation process. However it is also important to recognise that they are only one element and we should not forget the importance of long term contracts, which are required to bring investment forward and to provide an efficient and secure gas market.

From our perspective, the development of hubs is progressing well, under the existing legal and regulatory framework. Therefore we do not see any need for additional regulations or regulatory intervention. We believe that hubs should be allowed to develop based on market demand, with investors exposed to the associated risk and rewards.

¹ Total title transfers at the hubs mentioned (inclusive of reselling or churning)

6. Hub-to-hub transmission

The key issues with regard to hub to hub transmission are tariffication, interoperability, congestion management and investment. Both congestion management and investment are discussed in Sections 4 and 7 respectively.

With regard to tariffication, two points raised by the Consultation are harmonisation of tariffs and cross-subsidies. In terms of harmonisation, from GIE's perspective and as further elaborated in the 2005 GTE report on Transit, the specific situation with regard to cross-border flows varies significantly from country to country and therefore it is not appropriate to have a "one size fits all approach". This issue is detailed in the Gas Regulation, where it is stated that where tariff structures hamper trade across transmission systems then the convergence of tariff structures should be pursued. Therefore before pursuing the harmonisation of tariffs, there is a need to evaluate whether trade is being hampered.

On the subject of cross-subsidies, GIE is of the opinion that in cases where, taking into account the specific conditions in a Member state, the cross subsidisation is clearly identifiable and produces unacceptable distortions, the application of specific tariffs to transit could be more appropriate. Through implementing such a tariff the distortion should be ameliorated.

Following the formation of EASEE-gas in 2002, significant progress on interoperability has been made. EASEE-gas, that brings together players from all segments of the gas industry, has already developed six common business practices, including Harmonisation of Gas Quality, Interconnection Agreements and Constraint Management, which provide a harmonised approach to key processes in the gas industry. In developing and implementing these Common Business Practices, the industry is importantly taking into account both safety and security of supply concerns. EASEE-gas is now developing a European gas business model to consider other processes that would benefit from a harmonised and streamlined approach. We therefore welcome ERGEG's recognition of the importance of interoperability and would encourage the endorsement by regulators of the work of EASEE-gas.

7. Investments and regulatory powers / co-operation

The Roadmap should seek to set out the guiding principles of the regulatory framework that will make investments possible and economically feasible. The framework must address issues such as making investment in one country that benefits another and how to bring such investment forward. We believe that there needs to be flexibility in how investments are funded and that one form of remuneration should not be prescribed. In our opinion the guiding principles to be followed are:

- respective roles and responsibilities of market players should be clearly and appropriately defined and allocated (these could include Public Service Obligations) and security standards should be output-based;
- where possible the need for new infrastructure should be determined through market signals, supported by binding financial commitments;
- appropriate funding arrangements should be in place to underpin infrastructure investments, ensuring that the investment environment is:
 - predictable;
 - stable;
 - commensurate and complete

An additional point in relation to "complete" is that this should not only refer to the specific project e.g. LNG terminal, but should also take account of any investment required in local infrastructure to support the project.

It should also be noted, that Security of Supply may require investments that may not be valued by the market (e.g. risk of 1 in 20 winter). In such cases, an appropriate legal and regulatory framework

is necessary to make these investments possible across the gas supply chain. In countries where TSOs do not compete with each other, one party may need to take responsibility for data aggregation. The party selected, which in many cases will be a TSO, needs to be able to compile a full long term supply and demand picture. To achieve this, the party will have to be provided with information on the supply situation at entry points, including storage facilities, and the demand situation at exit points. To ensure that the information is provided and is of an appropriate quality there may need to be information obligations placed on the relevant market players, for example producers, storage operators and distribution network operators.

The Roadmap often refers to cross-border investment. In GIE's opinion this is a term well suited to the electricity industry, where investment may be limited to the interconnection between two grids. However we do not think that this term alone is suitable for the gas industry where the investment may involve infrastructure that is built over a long distance and spans several countries. We therefore prefer to use the term non-domestic investment.

We agree that the powers of the regulator and the co-operation between regulators are important issues that need to be carefully addressed. However, we should not lose sight of the aim of market liberalisation, which is to introduce competition where it is possible and economically viable to do so. Therefore regulation should be kept to a minimum and should be restricted to areas where competition cannot develop; these should be the overriding principles when considering the powers of the regulator. The roles and responsibilities of regulators need to be clearly defined and it is essential that the regulator is accountable for its decisions with an effective right of appeal procedure.

With regard to co-operation between regulators, this is an area where we believe significant improvements are possible, particularly for non-domestic investments. We think that this is a fundamental element for the successful development of regional initiatives. The main requirement is that regulators operate in a consistent and predictable manner. As infrastructure operators we have implemented Guidelines for Good Practices (storage and transmission access), that define minimum requirements of service throughout the European Union and govern our relationships with our customers. As many new and existing infrastructure projects are pan-European or are domestic projects that form part of important pan-European transmission routes, we would welcome similar developments in the field of regulation. We believe the following improvements to the current regulatory framework would help facilitate non-domestic infrastructure projects:

- an agreed set of regulatory requirements across the respective national and European authorities
- long term, stable conditions
- timely approval process
- effective and swift right of appeal procedure

As far as non-domestic investments include countries seeking to join the European Union, the principles described above should also be followed.

8. Summary

The Executive Summary at the start of the document summarises the main GIE views on the Roadmap. In brief these concern:

- the need for the road map to be holistic with tangible milestones
- the requirement to balance security of supply with the development of a competitive market, whilst taking national circumstances into account
- the development of a conducive investment climate
- the use of voluntary guidelines combined with full implementation of existing legislation to complete the single European gas market

In the following annexes, the specific questions raised by ERGEG are addressed and GIE's views on specific points raised in the Roadmap are provided.

Attachment 1: Response to ERGEG questions

General

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

We welcome the recognition of the importance of creating the right regulatory framework for all investments. However, we believe it is necessary to take into account the different characteristics of the various markets, as a fast growing market, such as Spain, is faced with very different issues to the more mature markets of North-west Europe.

The paper does not really address the issue of flexibility and balancing and how this should be provided for. We understand that this is being dealt with through the development of balancing principles by ERGEG. The results of this initiative need to be incorporated into the Roadmap.

Many of the approaches described in the Roadmap appear to have been transposed from the electricity market. Due to the close connection of the markets, in certain Member States, this may appear appropriate, however the different characteristics of gas and electricity and their respective markets needs to be carefully considered. The regional initiatives should take account and reflect these differences; for example the fact that gas is mainly imported into the EU while electricity is predominantly produced near consumption.

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

The paper does not sufficiently recognise the need to balance Security of Supply with the development of competitive markets. Competitive markets may not fully value Security of Supply therefore additional measures may be needed.

The need to take the national dimension, for example transit or fast demand growth, into account is also under-played.

The paper focuses on regulatory powers rather than regulatory consistency and predictability. These aspects should be addressed in order to provide the conducive investment environment for facilitating both national and non-domestic investments.

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

In many European countries the investment climate is not conducive. In Section 7 we have outlined guiding principles that should exist across the European Union to remove uncertainty and bring forward investment.

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

Please refer to Section 3. In addition, GIE welcomes the work of CEER, through its ECSEE Working Group, in progressing the establishment of an effective and competitive SEE energy market. The respective GIE Working Group is co-operating with a Task Force of SEE Regulators to establish particular Guidelines on Infrastructure Investment Regulation (GIIR) in the region. In this way an appropriate framework for trading and safeguarding investments and financing gas infrastructure in that region should be created.

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.

We agree that the need to consider how investments are funded and approved is extremely important. We have made suggestions with regard to how uncertainty within this process can be reduced (see Section 7).

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?

The key issues for developing effective competition are non-discriminatory and transparent access, as detailed within the Gas Regulation. It is also important that the infrastructure is used in an economically efficient manner, however this can be delivered through the implementation of effective UIOLI arrangements, interruptible contracts and secondary capacity markets.

Long-term contracts are a valuable tool since they allow infrastructure operators to mitigate risk. This is particularly relevant for transits, as the risk is greater than for domestic transportation. Transit flows depend on many factors including the demand in gas consuming markets, the relative costs of different supply routes and the stability of the various countries crossed.

From GIE's perspective, there should be flexibility in how investments are funded (see Section 7). We should allow different financing solutions, including for example long-term contracts or regulated asset bases. In addition, GIE believes that in the case of transits, due to the size and complexity of the investments involved, the use of long term contracts to secure the investments will remain an essential element of existing and future pipeline projects. Furthermore, a stable and predictable regulatory framework should be provided in order to attract and safeguard infrastructure investment on a long-term basis.

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?

GIE believes that there is potential for a competitive market offering logistical services. Therefore the market should be left to develop the most efficient solution and consumers should be given the freedom of choice, including the possibility of arranging transportation by themselves.

- 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.

The ITC scheme might be appropriate for electricity, where production is fairly well spread across the whole EU territory, resulting in limited physical cross-border flows. On the contrary, a significant proportion of natural gas is produced outside the EU, and transit gas flows reach very high levels in many countries, up to more than 90% of total flows. A mere "compensation mechanism" is unlikely to be sufficient to address such physical and contractual flows.

Our main concern with any such scheme is whether or not it would be able to properly remunerate existing investments and provide the market signals for new investments. Such an ITC scheme for gas would lead to a complete change of the current gas transport paradigm, making many TSOs almost completely dependant on the mechanism, and not able to manage their own business by commercial contracts.

Finally, we foresee that an ITC scheme would be very complex and bureaucratic to implement and maintain. GIE considers that the priority should be to focus on how to foster the necessary investments and hub to hub transmission.

- **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.**

As discussed in previous answers (see Section 7), we believe that there needs to be flexibility in how investments are funded and that one form of remuneration should not be prescribed. The regulatory framework should deliver a conducive investment climate, with the detail of the regime tailored to individual markets and national circumstances.

The way forward

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

We consider that the larger the region, the greater the difficulty to make tangible progress. Also combining countries that have very different structures, for example a mature market with a fast growing market is likely to lead to sub-optimal results. We believe that by defining regions that are relatively homogenous and manageable in size the quickest progress would be made. Potential regions could be for example a fast growing region, a mature region or a region with significant transit flows. We would welcome further discussions with ERGEG on the specific regions.

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

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

A conducive investment climate and proper market signals should alleviate long-term physical congestion. In contrast, interruptible contracts and secondary markets should largely mitigate contractual congestion. The implementation of current legislation should ensure that these elements are in place.

With specific regard to hub development, physical congestion is of course more relevant for physical hubs than for virtual ones. However even in this context, investment should be based on market signals and follow the principles given in Section 7.

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

From an infrastructure perspective, the previous answer is still valid.

- **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)?**

See previous comments (Section 3).

Attachment 2: Specific comments on ERGEG statements in the discussion paper

Unbundling

- 1) Paragraph 94: Unbundling of hub operators. Hubs as with all infrastructure should follow the principle of non-discriminatory and transparent access. In the case of hubs, we do not believe that this is of particular concern, as it is an essential pre-requisite for a successful hub, without this the credibility of the hub will be damaged and the hub will no longer be viable. Therefore it is in the interest of the investors in the hub and its customers to ensure that non-discriminatory and transparent access is provided.
- 2) Paragraph 122: The document suggests that in terms of incentivising TSOs to offer the maximum capacity there should be a different regulatory approach for TSOs affiliated to other market participants compared to TSOs without such affiliations. GIE does not support this discriminatory approach. The second Gas Directive establishes the unbundling arrangements and the conditions to be met by infrastructure operators, so long as these requirements are fulfilled, regulators should not discriminate against TSOs with different affiliations.
- 3) Paragraph 123: Infrastructure operators are committed and in nearly all cases incentivised to offer the maximum capacity of their assets to the market. The ability of TSOs to predict flows is limited and with the changing environment, including entry-exit systems, short-term trading and competing supply routes, there is increased uncertainty of flows. Therefore the firm capacity that infrastructure operators offer to the market must take into account all of these factors. Infrastructure operators make available additional firm and interruptible capacity as the certainty of flows increases. We believe that this approach minimises the risks to all market participants whilst maximising the usage of the system. As stated in the Roadmap Consultation, many TSOs do not offer firm back haul capacity for the reasons stated above, however in the majority of these cases interruptible capacity is offered to the market. We recognise that it may be possible to provide additional financially firm capacities based on increased incentives commensurate to the financial risks involved, but the overriding concern must be to ensure the integrity of the operating system under severe conditions. GIE is in discussions with ERGEG on this issue.

Other

- 4) Paragraph 53: The point is made that there is a significant risk with the use of voluntary guidelines (e. g. for storage access) because national regulators are unable to take monitoring and enforcement action to ensure that the market operates effectively. From GIE's perspective and experience this is not a significant issue, as in many countries, where it is felt necessary, the requirements set down in the voluntary Guidelines can be adopted into national market rules and suitably enforced by the Regulator. Therefore we strongly believe that the benefits of voluntary guidelines clearly outweigh any perceived disadvantages.
- 5) Paragraph 116: Creation of an EU wide entry-exit system. We believe a European wide Entry/Exit system would lead to:
 - either a decrease in firm capacity offered to the market, due to higher internal congestion or;
 - to higher transportation tariffs, as a result of huge infrastructure investments made to avoid internal congestion.

We therefore do not think that the creation of an EU wide entry-exit system should be pursued.

- 6) Paragraph 126: From GIE's perspective a swap is a transaction involving two trading parties. Infrastructure operators are usually not involved in such a transaction. Clarity from ERGEG on this point would be welcome.