

ERGEG Gas Regional Initiative

North and North West Regional Energy Market

DEFINITION OF WORK STREAM

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Regulatory Coordination and Investment

Issues and Challenges

Regulatory Coordination between member states is a key aspect in concluding the internal European market. Rules are already laid down by the Commission regarding this cooperation between member states, and can be seen in Directive 2003/55/EC (“the Gas Directive”) and Regulation 1775. For example, Article 25 paragraph 12 of the Gas Directive states, “*National regulatory authorities shall contribute to the development of the internal market and of a level playing field by cooperating with each other and with the Commission in a transparent manner.*” Article 10 of Regulation 1775 states, “*Where appropriate they [NRAs] shall cooperate with each other and with the Commission.*”. Working towards improving regulatory coordination is thus an obligation for all member states and regulators.

Although it is clear that EU NRAs should cooperate with each other, currently there are still differences with regard to the regulatory approach in the different member states. Currently there are no guidelines in place indicating the manner in which regulators should co-operate or what principles could be applied to such co-operation. To make progress on the cooperation and coordination between member states and regulators in the North and North West Regional Market, a common regulatory philosophy and approach to cross-border issues is required. This will contribute to more equal conditions for market parties and will create a more stable and more predictable regulatory regime within the member states, and to avoid the potential for dual regulation of cross border pipelines in particular. To achieve this will demand cooperation among the member states within the region. This workstream will therefore help the RCC to assess where political, regulatory or legal barriers exist and make proposals to address any issues arising if appropriate. It may be that resolution rests with each individual member state if a common approach is not practical.

A common challenge facing regulators in the regional market will be to forge a shared philosophy that facilitates regional integration, in particular, in attitudes to cross border flows, competition in transmission, and transit. A vital issue is how regulation in one member state impacts on the market of another. The RCC is driven by a shared belief that

market integration is to the longer term benefit of consumers in each national market. However, current approaches are not always driven by concerns for market integration. The RCC would need to understand what would happen if an action is in the interest of the regional market but not the individual member state. There will be a need for the NRAs to assess the effectiveness of arrangements and to evaluate proposed projects / existing infrastructure and changes from a European point of view rather than a national point of view and to re-evaluate parts of the current regulatory framework. This could include removing regulation where it is obsolete or unnecessary.

Scope of work

As a starting point this workstream does not envisage creating a new governance structure with new legislation in the region. Rather, the goal of the RCC should be to improve coordination and cooperation between regulators and to establish a transparent process of resolving disputes.

As a first step the EC, member states, TSOs, the RCC and other stakeholders need to agree a common European philosophy and approach to regulation with regional implications, such as interconnection, transit and investments. This philosophy is needed to improve the regional market and use it as a stepping stone towards completion of the internal market. Furthermore a survey mapping existing powers of National Regulatory Authorities in the region will be conducted by the RCC.

Once the RCC has a better understanding of NRA's powers, the RCC should then survey the existing regulation with a regional impact. This will help the RCC better understand where regulatory obstacles restrict the realisation of a regional market.

It is proposed that the RCC ties in to the CEER Regulatory Benchmark report 2005 (Ref; C05-IEB-08-03) and the ERGEG project of monitoring the implementation of Regulation (EC) No 1775/2005 ("Regulation 1775"). If the findings from the assessment of European energy markets¹ do not contain the needed information, some further questions would be added to their questionnaire to probe further into the regulatory powers of each member state. This will be a useful exercise in gaining experience of the approach of different member states in the region and may give insight into the different environments in which each member state operates. This may signal where structural barriers may arise in the future. The RCC recognises that some of this work may feed in with that in the Transparency workstream and possibly others, and the RCC will seek to co-ordinate this. The RCC should also attempt to identify any lessons that may have been learnt from the electricity RCC.

The IG has identified investment as a key area where regulatory coordination should be improved. Regulatory coordination is crucial for investment in the European gas infrastructure, because all major investments that are necessary have a regional implication. Europe is becoming increasingly dependent on gas from faraway sources.

¹ A Preliminary Assessment of the European Energy Market by the European Regulator's Group for Electricity and Gas (ERGEG), November 2005.

This means that pipeline systems crossing many countries and regulatory regimes have to be built and that the EU is competing on the world market for LNG. The regulatory frameworks should provide the conditions necessary for investment. The investment climate should be stable, commensurate and complete. Currently, there is limited new investment without exemptions according to art. 22 of the Gas Directive, because this is not the case.

To improve coordination and cooperation between NRAs and to shape the common philosophy, a set of guidelines has to be set up for NRAs on how to evaluate investments / existing infrastructure and proposed changes to the individual systems from a European point of view. Furthermore these guidelines will cover how the NRAs should interpret article 22 of the Gas Directive (exemptions). Different interpretations of article 22 of the Gas Directive and what is considered a reasonable return on investment within Europe and the N/NW region will distort investment decisions by directing capital to areas with a more liberal approach, even outside the EU. Therefore, a common regulatory approach regarding investment is crucial for the development of the internal market. Furthermore, the guidelines should ensure that for pipelines that cross a number of Member States (long distance transmission and transit, with or without application of Article 22 of the Gas Directive) the role of the NRA in each jurisdiction is defined such that dual regulation is avoided and sufficient confidence is given to investors concerning their investment risk and an appropriate remuneration. For certain projects/border points suitable legal constructs, e.g. Memorandum of Understanding should be put in place between the NRAs and made available to the relevant TSOs.

In a first step there should be a focus on investment in infrastructure in cross-border transmission capacity and LNG as they have implications for the regional market. In principle there is competition between the different supply sources and also the routes that are being used to transport the gas to the point of demand. Investments in this type of infrastructure should be undertaken by the market; there should only be regulatory intervention where there is no competition. In any case a level playing field should be ensured.

Transmission

Investment in gas infrastructure is characterised by very high initial investments and long payback periods. Investors therefore require stable conditions far into the future before taking investment decisions. The challenge of the work stream is to develop guidelines for regulatory frameworks that will ensure a good investment climate and bring forward the necessary investment in transmission pipelines. TSOs should ensure investment on adjacent networks especially at cross border points is co-ordinated.

LNG and storage

Investments in LNG terminals and storage throughout the North Western European region are in competition with other supply and flexibility sources in and outside the region and with each other. Therefore, a level playing field regarding the conditions for investing in new capacities is crucial.

Concerning LNG terminals, practice has shown that very few LNG investments without exemption according to article 22 of the 2nd Directive are taking place. Concerning storage, many potential investors consider nTPA crucial for the economic viability of their projects and are currently hesitant to invest because of the uncertainty whether the current possibility for negotiated Third Party Access (nTPA) regime will be removed. There is therefore a need to reinforce the possibility for nTPA as it is currently established in the second gas Directive.

Work Plan

Improving regulatory coordination is a crucial component in creating better integrated more harmonised markets. Therefore progress on this topic is very important to be able to reach the goals set in the Gas Directive.

Issue	Description	Responsibility	Timing
<u>Fact finding stage</u>			
1. Philosophy on regulation	A shared philosophy on regulation with regional implication to be produced and presented, including how to deal with investments with cross-border impact, the role of each regulator involved in cross-border pipelines and interpretation of article 22 of the 2 nd Gas Directive.	RCC involving all stakeholders and in particular the Operators and also EC and member states	September - end January 2007
2. Develop an understanding of each NRA's current powers, and areas of regulatory overlap.	CEER and other ERGEG work have or will form an overview of the powers of NRAs. If there are still gaps this REM will issue the questionnaire of ERGEG to each NRA for the missing information. If necessary the RCC will add questions. This work will deliver a matrix of NRA's powers.	The RCC will draw up a matrix of powers and regulatory overlap using ERGEG and CEER information.	September – end November 2006.

3. Develop an understanding of regulatory coordination issues faced by TSOs.	TSOs and interconnectors to produce an overview of regulatory coordination issues faced.	TSOs and interconnectors within the IG	September – end November 2006
Madrid	Inform of work plan and progress.		December 2006
4. Compare results from TSO's paper and RCC matrix and produce conclusion paper.	The results from the matrix and TSO paper will be compared with the overall philosophy developed and identify barriers that may exist. Based on this a conclusion paper will be produced.	RCC with full involvement of IG	end February 2007
5. On the basis of the common philosophy, develop guidelines for regulators/regulation	Guidelines for regulation will be developed, if deemed necessary, in order to remove identified barriers.	RCC with full involvement of IG	February – end March 2007
<u>Madrid</u>	Presentation of philosophy, identified barriers and guidelines for regulators.	RCC	May 2007
6. Undertake full stakeholder consultation on the guidelines.	The Guidelines presented at the Madrid Forum should be consulted upon and revised based on the outcome.	RCC	May-end July 2007
<u>Action stage</u>			
7. Establish a process of regional coordination.	Further issues regarding regulatory coordination are likely to arise. The RCC should establish a process to facilitate better regulatory coordination and dispute resolution.	RCC with full involvement of IG	January 2007 – end April 2007

References

- ERGEG Gas Focus Group TF TRA – Questionnaire to regulators concerning the level of TSOs compliance with the transparency requirements of the Gas Regulation (1775/2005/EC);

- Regulation (EC) No 1775/2005 of the European Parliament and of the Council of 28 September 2005 on conditions for access to the natural gas transmission networks;
- A Preliminary Assessment of the European Energy Market by the European Regulator's Group for Electricity and Gas (ERGEG), November 2005.
- CEER Regulatory Benchmark Report 2005 (Ref; C05-IEB-08-03)
- Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC.