



Gas Regional Initiative - Region: South-South East

An Action Plan for the South-South East Europe Natural Gas Market

A Consultation Paper

1. Introduction

More than two years after the second Gas Directive, the European Commission DG TREN Benchmarking Report¹ and DG Competition's preliminary report on its energy sector inquiry² found that the European gas market still suffers from lack of liquidity, low customer switching rates, and low price convergence. Despite the fact that nearly 60 % of natural gas that is used in the EU crosses at least one national border, markets are still mostly national in scope and hardly integrated. Most of them are highly concentrated, and little competitive pressure arises from foreign suppliers.

The European Commission has insisted that full compliance and practical implementation of the Directives – and from 1 July 2006, also of the new Regulation 2005/1775 – is the key to the development of competition. The current picture of the European gas market is however still far from being sufficiently in line with these requirements. Monitoring of market participants' behaviour³, indicates a considerable lack of transparent access rules in gas transit, leading to significant differences between individual systems – which may have an impact on the efficient flow of gas.

¹ European Commission, Directorate-General for Energy and Transport (DG TREN), Report on progress in creating the internal gas and electricity market, http://ec.europa.eu/energy/electricity/report_2005/doc/2005_report_en.pdf.

² European Commission (Competition DG – Energy, Water), Energy Sector Inquiry Draft Preliminary Report, published 16 Feb 2006, http://europa.eu.int/comm/competition/antitrust/others/sector_inquiries/energy/#16022006.

³ E.g. Council of European Energy Regulators, Monitoring Report 2004 concerning Compliance with the Guidelines For Good Third Party Access Practice to Gas Transmission Systems.



On 28 March 2005 the Energy Regulatory Group for Electricity and Gas (ERGEG) published the “Roadmap for a competitive single gas market in Europe”, an ERGEG Discussion Paper for Public Consultation Paper” (henceforth: the Roadmap). It set out a number of priorities to be tackled if the goal of a single competitive European market in gas is to be realised:

- regulatory co-operation;
- unbundling;
- transparency and information handling;
- availability of gas;
- effective access to network capacity;
- gas quality

Further, remarkable discrepancies have emerged in the implementation of the Directive between Member countries. Uneven implementation and lack of reciprocity are often advocated by Member States as the reason for limiting the implementation of Directives to a minimum, to the letter rather than the spirit of its provisions.

To overcome practical difficulties, harmonised, transparent, and effective access and tariff rules should be implemented along the whole path followed by natural gas from production or entry into the territories of the European Union, and the consumption market.

An in-depth, internationally harmonised and continuous monitoring of their actual implementation may however be hard to implement from the onset for such a large economic and geographical space as the whole European Union, where very different situations exist. Therefore, the development of a functioning internal gas market may effectively start from ensuring that gas transport across borders is organised efficiently on a regional level. Better results may arise at first from a closer cooperation between Member States, regulators, system operators and stakeholders involved in arranging for gas to be flowed across neighbouring countries. In particular, some form of cooperation between transmission system operators is a possible way of improving and streamlining TPA arrangements, removing several practical difficulties. In turn, this may require a strengthened harmonisation of certain regulatory aspects between neighbouring gas systems on a regional level.

Therefore, the Roadmap proposed creating a Gas Regional Initiative (GRI), made up of a small number of regional energy market projects (REMs), to push forward the development of competition at a practical level.

The final goal of the GRI is the development of liquid trading at, and between, gas hubs as the basis upon which regional markets will develop, and their eventual integration and convergence into a single European market. Enhanced cooperation between a limited number of participants, as it happens on a regional basis, would ensure a higher degree of collaboration than

can be found at an EU-wide level, and help removing obstacles to the development of a more liquid market.

Responses received to the Consultation Paper from a wide range of interested parties including network operators, suppliers, consumers (and their representatives) and other market participants broadly agreed on the need to tackle the above identified priority issues. Therefore, on 25 April 2006 ERGEG launched the Gas Regional Initiative (GRI).

The GRI is entirely consistent with the European Commission's policies on competition and security of supply and ERGEG welcomes the support, in particular, of DG TREN and DG COMP.

The GRI will bring together regulators, companies, Member States, the European Commission and other interested parties, overseen by ERGEG, which will monitor the process to ensure smooth progress towards a single energy market. While the goal remains the establishment of a single EU market, it will start from the development of four Regional Energy Markets (REMs).

In each region regulators set up a Regional Coordination Committee (RCC), and establish a Stakeholder Group (SG) where all legitimate interests are represented, and a more restricted Implementation Group (IG) consisting of those stakeholders from which action is expected to improve market efficiency, mostly transmission and storage system operators. Representatives of the European Commission and of concerned National Ministries are also invited to meetings of both groups.

In the first phase of the GRI, expected to end in Autumn 2006, the RCCs will outline an Action Plan, after consultation of all stakeholders in each REM, to be implemented over 3-5 years. The present Consultation Paper is an essential part of such process.

Written comments are invited on the Paper, and particularly on its discussion points, and should be sent to Ms. Edith Übeleis (edith.uebeleis@e-control.at) and Ms. Rosita Carnevalini (rcarnevalini@autorita.energia.it), not later than 5 September 2006. Such comments will be published on ERGEG website unless confidentiality is explicitly requested.

Proposals of the Consultation Paper will also be discussed in public and restricted meeting to be held on 27 September 2006 in Bratislava.

2. The South-South East Gas Market: A preliminary assessment

ERGEG has defined the REM "South-South East" (SSE), comprising Austria, the Czech Republic, Greece, Hungary, Italy, Poland, Slovakia, and Slovenia. Their combined gas market (Table 1) amounts to ca. 142 Bcm in 2005, about a quarter of the whole EU, with an average per capita consumption of 990 m³/year, slightly below the European average. The market may be regarded as mature in most countries, with the exception of Greece, where gas was introduced in the energy mix ten years ago and the market has only recently been liberalised, and partly of

Poland; however demand is still growing in the whole region, notably in the power generation sector.

This region is extremely important for its transit contribution: nearly half of gas used in the EU is transported through the countries of the SSE. Currently most such flows originate in the former Soviet Union, but SSE is also expected to become a major transit area for gas coming from Central Asia, the Middle East and Northern Africa.

This REM includes countries that have important common features (Table 1): notably a limited self sufficiency (14% on average), mirrored by high dependence on imports and particularly on the largest supplier: Russia alone accounts for 46% of all gas used in SSE. Lately, such dependency has also raised security of supply concerns.

The gas transportation network of the region is centred on the strongest European pipeline system (Brotherhood) entering Slovakia from the Ukraine, with a primary junction in Slovakia and further splits in Austria (Baumgarten) and in the Czech Republic. The Southernmost branch reaches Italy while parallel lines cross Hungary and Slovenia. From SSE gas of mostly Russian origin transits into Germany and France and into the Balkans.

This is a large and powerful interconnected system, featuring some spare capacity in the Slovak and Czech sections but with bottlenecks in Austria that generate congestion affecting Southern Austria, Slovenia and Italy.

At the outskirts of the regions different cases occur. On the North, Poland hosts in turn a large westbound transit system and is only poorly directly connected with Czech and Slovak Republics, however it shares the main features of the SSE market and would be interested in more effective interconnection with the rest of SSE for competitive and supply security reasons, to which is already connected through eastern Germany.

On the South East, Greece is currently interconnected only with Bulgaria, while an interconnection with Turkey (and hence with Middle Eastern and Caspian suppliers) is under construction and is expected to be completed by the end of 2006. A new interconnection with Southern Italy (and hence the rest of the EU) is in the planning phase and is expected to be completed by 2011. Greece also has an LNG terminal (currently under expansion) with significant spare capacity.

It is worth recalling that the Energy Community Treaty was signed on October 2005, between the European Community and eight South East European countries, aiming at establishing the Energy Community in SEE. Five SSE countries have a specific role in this Treaty, which enters into force in July or August 2006. Such countries are expected to host a new pipeline system known as "The Fourth Corridor", which has pan-European relevance as a potential source of new and diverse natural gas supplies.

On the South West, Italy is the largest SSE National market, is connected with Algerian and Libyan gas fields through the Transmed, with France and Germany through Switzerland and has

an LNG terminal, and more under construction. Despite its potential to become a bridge for African gas bound for the rest of Europe it has been affected lately by capacity and gas shortages.

SSE countries currently include two “hubs”. A physical hub at Baumgarten, conveniently located at or near major pipeline interconnections and storage facilities; and the Italian notional hub, a “virtual exchange point” (PSV). However, almost 16 active traders at Baumgarten trade ca.. 500 Mcm per month. Little liquidity (compared to NW European hubs) is available on the Italian hub, currently consisting of the PSV and border points, which lately averaged ca. 870 Mcm/month, of which ca. 220 at the PSV.

Table 1 – Main gas market indicators (2005)

	Gas consumption per capita	Market size (bcm)	% of gas from domestic production	% of gas from largest foreign country source	% controlled by largest company
Austria	1109,8	9,1	20%	59%	75%
Greece	243,4	2,7	0%	75%	100%
Hungary	1470,0	14,8	19%	70%	95%
Italy	1482,6	85,1	13%	32%	68%
Slovenia	547,0	1,1	0%	57%	100%
Slovakia	1206,6	6,5	3%	97%	100%
Poland	345,5	13,2	31%	46%	100%
Czech Republic	935,6	9,6	1%	71%	100%
South-South East	990,2	142,1	14%	46%	79%

Source: DG TREN Benchmarking Report 2005 and National Regulators

A quick look at the current market structure and regulation helps explaining such lack of liquidity. First, SSE countries display high market concentration: 79% on average is controlled by each country’s dominant companies, with several countries still almost under monopoly. Such dominant companies have a limited interest in liquid markets and trading at hubs.

On the other hand, SSE is a clear example of the regulatory differences hampering competition development in neighbouring countries: for example unbundling of TSOs ranges from the minimum allowed solution - legal unbundling without assets, where the TSO does not even own the main assets it runs - to cases where ownership unbundling is about to be introduced.

TPA regulation was recently introduced or revised in all countries but it is highly differentiated in almost all main chapters (tariffs, capacity allocation, congestion management, balancing), as it appears at a glance from Table 2. Further differences may of course appear in a more detailed

analysis. It is not surprising that even a shipper endowed with upstream gas, who needs crossing two or three countries to reach his customers, faces an uphill task to define carriage contracts across the different systems. Contract duration, tariff systems may change along his route, service specifications including balancing provisions may not match, even gas quality requirements may be a problem.

However, the high import dependency may also be related with a lack of upstream gas, so that even the removal of all service inconsistencies may not lead to a significant liquidity increase.

A correct understanding of the difficulties requires an in-depth analysis of the current situation, which starts from DG TREN's Benchmarking Report and DG COMP's Preliminary Report, but needs more details.

In order to correctly understand the issues SSE national regulators are currently undertaking a data collection process, parallel to consultation, following a commonly agreed questionnaire. The information collection and elaboration will be repeated in the following years in order to detect the evolution of the main issues.

Table 2 – Main regulatory provisions (as of 31 December 2005)

	Declared market opening (%)	Transmission tariff structure	Capacity booking procedure	Unbundling of TSO	Regulator powers with regard to transport tariff
Austria	100%	post/distance	flexible	legal	ex-ante
Greece	70%	post-stamp	first come first served	legal (by end 2006)	ex-ante
Hungary	69%	entry-exit	auction	ownership	ex-ante
Italy	100%	entry-exit	flexible	legal	ex-ante
Slovenia	90%	post-stamp	pro-rata	legal	ex-ante
Slovakia	74%	entry-exit	first come first served	Legal	pricing method
Poland	72%	distance	first come first served	Legal	ex-ante
Czech Republic	20%	post-stamp	first come first served	legal	ex-ante

Source: DG TREN Benchmarking Report 2005 and National Regulators

3. Priorities for the South- South East Europe Gas Market

The RCC suggests that the Action Plan should focus on some priorities for the SSE region. The GRI will assess their current status, identify problems, suggest how to remove them and periodically monitor the outcome of undertaken actions.

Transmission, storage and hub operators will be the main subjects of the activities.

A preliminary assessment of the hottest issues has led the RCC to identify the following priorities:

- I. Monitoring of regulatory involvement in compliance with the Gas Regulation
- II. Practical case study: transport of gas through the region for specific transport profiles by fictive shippers
- III. Transparency requirements covering access to storage and hub services
- IV. Interoperability issues

Discussion point 1. Do you agree on such priorities? Are there any other issues to be included?

Priority I. Monitoring of regulatory involvement in compliance with the Gas Regulation.

It is necessary to monitor the actual implementation of TPA provisions and the enforcement of the *Regulation on conditions for access to the gas transmission networks*, No. 1775/2005⁴ (henceforth: the Regulation) after 1 July 2006. While, as an EC Regulation, it does not normally require any new primary legislation to be implemented, it is most likely that secondary legislation modifications and/or system operator action would be required. It is therefore appropriate to monitor its practical implementation in this occasion, with a view to streamlining TPA and other provisions across the REM.

Regulators and stakeholders will in particular assess whether any minor or major modifications of primary and secondary legislation and system operation rules and procedures are needed to meet the requirements of the Regulation, in the following areas:

- Tariffs
- Convergence of tariff structures and balancing charges
- Capacity allocation and congestion management mechanisms
- Interruptible service
- Transparency requirements

⁴ Official Journal L 289 , 03/11/2005 P. 0001 - 0013

- Balancing rules
- Regulatory powers, sanctioning regime
- Other access rules.

In particular, implementation of Regulation 2005/1775 involves the adoption of *Guidelines*: as a first step, it should be ascertained whether gas transportation and storage systems are already compliant, or any recent developments occurred, or no change occurred as yet. Issues covered by the Guidelines notably include the availability of:

- Short term capacity
- Network codes or standard contracts
- Nomination and capacity transfer procedures
- Service information
- Inter-TSO coordination
- Maintenance information
- Technical information for shippers

Discussion point 2. Stakeholders are invited to comment on the implementation of the Regulation and to suggest in which areas and countries action may be necessary.

The monitoring exercise will also comprise an assessment of the implementation status of the 2nd Directive⁵. Regulators will be noting if any infringement procedures have been started and signal shortcomings of the 2nd Directive implementation in each country.

Discussion point 3. Stakeholders are invited to signal in which areas and countries the implementation of the 2nd Directive is inadequate.

In particular, it will be important to verify the scope and guidelines of regulatory powers, as well as their actual use, concerning:

- Issuing detailed unbundling rules
- Issuing TPA tariffs or the methodologies to set them

⁵ 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, *Official Journal L 176*, 15/07/2003 P. 0057 – 0078.

- Defining capacity allocation criteria
- Outlining and approving balancing regimes
- Treatment of cross border disputes
- Issuing adequate sanctions for the enforcement of their powers and other secondary legislation.

Priority II. Practical case study: transport of gas through the region for specific transport profiles by fictive shippers.

As the general focus of the GRI is trade at hubs and between hubs, a survey of the current development of hubs and of other trading activities in the region is the obvious starting point. Main data on trade in existing and developing hubs, wholesale market participants and their supply share, the share of short term contracts and other liquidity measures shall be investigated.

However, since it is clear that hub trade is very much underdeveloped in SSE, most efforts will be devoted to understanding and removing reasons that hinder it. In this respect it will be necessary to track:

- the main physical and commercial gas flows, by country;
- the current and expected infrastructure development and its regulatory framework, including the main planned expansion of capacity, particularly as regards interconnectors, LNG terminals, storage facilities and plans for bottleneck removal;
- TPA exemptions awarded under Article 22 of the 2nd Directive and its regulatory regime in each country.

In order to effectively verify reasons of low hub effectiveness and lack of liquidity in the SSE, practical case studies of gas transportation through the region for specific profiles (routes) by fictive shipper will be performed. These will be undertaken by a “check list” covering such questions like:

- Is the selected profile viable?
- Is it currently used by several shippers? What are their shares?
- Are capacity and other data like applied balancing regime, terms and conditions for ancillary services published?
- Is spare capacity available on a long term and/or short term basis?
- Which capacity allocation methods are used (first come first served, auctions, open season, other)?
- Are capacity release or “Use it or lose it” clauses currently used? How?
- Which tariff methodology is applied (entry exit, postage stamp, distance etc.)?

- Can tariff levels be provided for selected routings and standard transportation patterns?
- Can the rate of returns of the concerned pipelines be defined or estimated? Are they derived from negotiated or regulated settings?
- Is transit and domestic transportation handled in a different way by TSO? Is there any cross-subsidization between them?
- Is there any secondary capacity trading, by private negotiation, or through a public board?
- Are there any access conflicts? Are they settled by the Regulator, the Competition Authority, the Ministry?
- Are backhaul services available? Are they actually used? At which terms and conditions?
- Are gas supplies available upstream? Which are the sources and their features?
- Is trade hampered by cross border inconsistencies as regards capacity or tariff settlements (e.g. non-matching zones, capacity allocation periods and criteria, balancing requirements)?
- Is lack of access to storage a problem?
- Is trade hindered by regulated end user prices, which may not be cost reflective or affected by cross subsidies?

The case studies will be applied to the following transportation profiles:

- RUS-SK-CZ-GER (Velke Kapusany - Waidhaus or Hora Svate Kateriny)
- RUS-SK-A-SI-I (Velke Kapusany - Goricia)
- RUS-SK-A-I (Velke Kapusany - Tarvisio)
- RUS-SK-A-GER (Velke Kapusany - Oberkappel)
- RUS-PL-GER-CZ (Bobrowniki or Kondratki – Mallnow - Hora Svate Kateriny)

Each transportation profile may be examined by its separate national sections as these may be currently run differently.

Discussion point 4. Stakeholders are invited to signal difficulties they may have encountered in the use of transportation routes in the SSE region, by considering the above check list.

Priority III. Transparency requirements covering access to storage and hub services

Market liquidity is greatly increased by the availability of special centralised but open services, which are often offered by storage facilities or, in more advanced situations, by hubs. The following items should be verified:

- Is access to storage services separately available?
- Are (or could, in principle) storage services of the country used by foreign parties

- Is storage access regulated?
- Are other domestic or foreign storage and flexibility service providers available?
- Is storage in the country subject to public service obligations including those related to security of supply?
- Are hub services available (e.g. Title transfer, Matching nomination, Wheeling, Parking, Loaning)?

Discussion point 5. Stakeholders are invited to signal availability of such services and to suggest steps that may facilitate their introduction, by considering the above check list.

Priority IV: Interoperability issues

Gas quality and technical interoperability issues may hinder gas transportation along international routes:

- Are infrastructure interconnection agreements fully enforced and competition friendly?
- Are operational balancing agreements enforced?
- Are any gas quality problems hindering interoperability?

Discussion point 6. Are interoperability issues in the SSE region hindering competition in the SSE region?

4. Some preliminary conclusions

A full diagnosis of the difficulties that have so far hampered the development of liquid gas markets in SSE requires the analysis of priority issues, as outlined in the previous section. However, European Commission Reports and preliminary assessments by national regulators have underlined that in Europe, and particularly in SSE countries:

- the gas market is not transparent and confidentiality provisions are often used as a cloak to avoid disclosing relevant information;
- a high level of concentration still prevails and has not significantly changed after liberalisation;
- incumbents largely control domestic production and import supplies and dominate traded markets;
- gas infrastructure is mostly owned or controlled by incumbents and not adequately unbundled;
- long term transit and storage capacity reservation to existing contracts leaves little room to new entrants, even on a short term basis, and leads to inefficient infrastructure development and utilization;
- cross border competition also fails to exert significant downward pressure on prices;

- prices are mostly linked to oil and derivatives and fail to adjust to demand and supply fluctuations;
- regulatory co-ordination is not adequate and is hindered by asymmetries in regulators' powers.

In particular, the main difficulties found in each SSE countries are as follows.

In **Austria**, alternative suppliers need access to interconnector capacity to be able to market gas in the domestic market. Up to now system access in transit pipelines has been on the basis of negotiated contracts, and will be regulated from 1st Jan 2007 on the basis of a "one stop shop" TPA model also for transit systems. Because of this no information is available as to how long-term transport rights on the transit pipelines are assigned, i.e. who has access to which second-level wholesale markets (Germany, Italy, etc.). It is difficult for new entrants to obtain access to transit pipelines. No capacity is currently reserved for new customers on any of the cross-border pipelines. Here, it should again be noted the existing long-term capacity reservations are often for affiliates of the system operators; some are not matched by physical flows. Neither the offer of interruptible capacity nor transparent secondary trading in transport rights would be sufficient to enable a new supplier to enter the market. It is thus consistent with the European Commission's approach that the 2nd Directive requires regulated access to all gas networks.

CEGH (formerly named "Gas Hub Baumgarten") is a 100% affiliate of OMV Gas GmbH. Besides the auctioneering service for Gas Release Programs, CEGH offers year-round commercial and logistic services, without trading gas itself. Since its foundation in the year 2000 the number of customers trading in Baumgarten as well as the traded volumes (ca. 500 Mcm/month) is much lower than at other European Hubs. For the time being 20 gas traders (wholesalers) are using the CEGH platform for their trading business, whereas the most requested CEGH service is title transfer at various trading locations like Baumgarten. CEGH offers Title Transfer, Wheeling, No Notice Storage nomination and Gas auctions.

Due to the long transport routes the gas deliveries from the producers do not mirror end-users' demand behaviour but are made in equal amounts (fixed quantity deliveries). Gas storage and balancing energy are therefore essential for a supplier to serve final consumers and local distributors, as it would otherwise be unable to respond flexibly to demand. Storage costs are equal to between 5–15% of energy costs, and thus have a significant impact on competition. Austrian storage tariffs are negotiated and are not subject to any form of regulation. RAG and OMV are the only storage operators in Austria, and the significant influence exercised by them on the costs of their competitors in the gas supply market represents an additional barrier to entry.

In the **Czech** Republic, the gas market was fully regulated until 31st December 2004. According to the European and national legislation liberalisation of gas market started in the Czech

Republic for 35 eligible customers (approx. 20 % market share) on 1st January 2005. Since 1 January 2006 the market is open for all final customers except households (approx. 70 % market share) and since 1 January 2007 the market will be fully liberalised for all customers including households. During 2005 almost half of eligible customers started to choose an alternative new supplier but only two eligible customers were successful. The most important difficulty for newcomers was a very problematic access to available capacity in underground storages that are owned and operated by former incumbent RWE Transgas. Two eligible customers changed their supplier mainly because of almost totally flat profile of their delivery where access to underground storages is not necessary.

Due to a very negative experience gained by first eligible customers with the first step of market opening (for example higher market price offered by incumbent than a regulated price, very complicated access to network and border points) the Energy Regulatory Office decided to re-regulate gas market starting 1st January 2006.

The Energy Regulatory Office set a maximum price for eligible customers for gas deliveries and for storage services offered by RWE Transgas. Anyway it is still possible for eligible customers to choose their supplier and to sign a Gas Sales Agreement with their former supplier or newcomer. This price would be probably based on a common price-formula.

At present the Energy Regulatory Office is negotiating with RWE and other players at the Czech gas market about cancellation of re-regulation that is planned for 31st March 2007 but these talks are pending.

For **Greece** no conclusions can be drawn on such issues, as the market has just been liberalised.

In **Hungary**, the gas market is in a transition period with the co-existence of public service and free market. Transmission and storage fees and commodity prices are regulated for the customers in public service. This situation is one of the reasons, that only a few customers (with about the 10% of the Hungarian yearly gas consumption) have entered the open market while the consumption of eligible customers is 69% (only the households and some communal customers are not eligible).

The transmission tariff system does not foresee short term capacity booking. As a consequence of which capacities are booked for a whole gas year and unused capacities are not sold. In spite of congestion in cross-border transmission capacity at the import entry point of the eastern border, there is no difference between the western and eastern import entry tariffs. Charges for imbalance and for incorrect nominations are symbolic and are not a sufficient incentive.

Low gas prices in the public sector, uncertainties of the new gas market model under planning and the rapidly changing legal framework hinder customers from entering the open market. This is also the case for gas traders. There are only two effectively active traders on the open market and eleven traders having licence are waiting. For transmission, ownership unbundling is realised. The incumbent vertically integrated gas company sold its trade and storage subsidiaries and kept the gas transmission subsidiary. There is a transit crossing the country (and the EU) and using the Hungarian network. It is handled confidentially and separately from the domestic transportations.

In **Italy**, the overall pattern described above was only partly mitigated by regulatory actions, increasingly strong unbundling and some gas release. Legal unbundling and partial ownership unbundling of the transportation network have not reduced its control by the incumbent, which also controls almost all storage facilities. Ownership unbundling of transportation through a 20% shareholding limit by suppliers has been planned for 2008.

The impact of gas release has been lower than expected, as the incumbent has been allowed to select the beneficiaries as well as prices. Import capacity bottlenecks and long term reservations in the pipelines from Austria, Switzerland and Tunisia, as well as delays in the authorisation and construction of new LNG terminals and storage facilities, have led to reduced supply increase with respect to demand, hindering competition, pushing prices up and fostering gas shortages in the last two winter seasons. While a number of new players have entered the market their gas availability has remained mostly small and fragmented. The new virtual hub (Virtual exchange point or PSV) has been launched but has reached only a low liquidity level.

SSE regional market covers important transit countries. The Jamal pipeline crosses territory of **Poland**. Due to advantageous conditions to render transit services Poland is too dependent on Russian Gazexport, which accounts for 41 % of Polish consumption.

Liberalization process of internal market has not been advanced enough. Lack of access to storage services is one of many important barriers faced by newcomers. The access to storage capacity constitutes the source of technical flexibility, which is needed in order to maintain obligatory emergency stocks of imported gas. Unfortunately, TPA to storage service implementation has been only recently initiated, therefore it is not sufficiently advanced.

Unlike in the storage case, legal unbundling of the transmission grid operator has been performed successfully. Finally, the implemented transmission grid code seems to be an asset.

In **Slovakia**, the importer acts in fact in a position of an import monopoly bringing natural gas from one source. For the development of a liberalised and flexible gas market in Slovakia, it is important to achieve the diversification of sources and of states, for the purpose of increasing the

security of supplies. These are presently secured by long-term contracts with Gazprom through the territory of Ukraine and supplying West Europe (output point Lanžhot) and South-West Europe (output point Baumgarten). Preparation of possibilities to use the natural gas from Norwegian, Algerian, Asian (Nabucco) sources and LNG is ongoing.

Slovakia is typical of its east-west transit orientation. North-south road has not been developed. Within the diversification and strengthening the supply security, a transit structure should be built by interconnecting the north-eastern transit road from northern Poland further through Hungary to the planned Croatian LNG terminal in Krk.

Slovakia is foreseen to be developed in connection with Austria and the Czech Republic as a storage centre for Europe, in order to strengthen the security of supplies transported by transit pipeline through Ukraine to the West-European states.

In **Slovenia**, legal unbundling of the incumbent Geoplin d.o.o. on transmission network was performed successfully, however this is not the expected condition for a full liberalisation. Legal unbundling of transmission company still did not result in a desired reduction of influence of the vertically integrated company. There are some doubts from the regulatory point of view, if the level of the unbundling procedures is enough for making fully independent decisions, according to the fact that the owner of the system operator is still the former incumbent.

The Slovenian transmission network is currently 100% congested with the capacity's for the domestic consumption and transit. The new investments in the network infrastructure in the next 5 years will double the transmission capacity for the domestic consumption and transit. Also a new compressor station in Ajdovščina will be build to extend the system flexibility and extend the system services.

Entrance of new suppliers is possible. There are still some barriers which should be taken into account because of many specifics. One of them is the long term contracts which were renewed and contracted for the next 10 years (2007 - 2017). The next barrier for entering suppliers in the Slovenian market is also the competitive price policy of our incumbent, which is reducing the interest of suppliers to enter the Slovenian gas market.

The security of supply aspect should also be mentioned in connection with long term contracts. Slovenia at this time does not have any storage facilities and is also 100% import dependent, which means, that Slovenia has no production of natural gas and is highly dependant from imports from Russia, Algeria, Italy and Austria.

5. Proposals for an Action Plan

It has been stressed and it is widely agreed that a full implementation of both the 2nd Directive and the Regulation 2005/1775 are needed to start removing the difficulties that have so far slowed the development of the single European gas market, particularly in SSE countries.

While it is beyond the scope of the present paper to discuss any new legal provisions, it is necessary that national legislation ensures:

- unbundling provisions entailing full independence in capacity allocation, implementation of non-discriminatory balancing regimes, avoidance of cross subsidies between different infrastructure users, transparency of capacity and any other useful information;
- incentives on TSOs to provide a level playing field and to develop economically efficient network reinforcements;
- regulators fully endorsed with the role indicated by the 2nd Directive and Regulation, including substantial independence and adequate monitoring and enforcement powers.

A detailed Action Plan will be developed after the acquisition of detailed information as described in the previous section. However the preliminary assessment already suggests that the Action Plan may include the following regulatory harmonization proposals, aimed at a joint implementation of the Regulation and consistent with views expressed in the Roadmap, where it is suggested that “achieving the necessary co-operation between regulators would be through extending the existing framework of regulation including the role and function of ERGEG. It will be important to ensure that there is no unnecessary duplication (or inconsistency) in regulatory powers.” Regulators are committed to consider prioritisation of less cost intensive measures (if different measures provide the same solution quality) when developing an action plan.

1. Regulators of the region should agree on common guidelines for capacity reservation and capacity usage, at least for some part of total international transportation capacity of routes mentioned under section 3 above (*one stop shop principle*); including provisions for interruptible services and capacity release in case of commercial congestion. Such guidelines may be more precise than those required by the Regulation and specify capacity lots to be offered by size and duration, including a common allocation procedure, and consider implications of the European Court of Justice decision - 7 June 2005, C-17/03.

Discussion point 7. Do you agree with this proposal? Is any other solution to the congestion management preferable?

2. As the Roadmap stated, the regulatory framework (and the responsibilities and obligations of TSOs) as it currently stands is inadequate to deal with a sensible allocation of costs and risks, particularly where the principal beneficiaries of investments are located outside of the TSOs’

network – i.e. there is a regulatory gap which can impede investment. To remove this gap, Regulators should study a regional transportation tariff based on the entry-exit methodology, with a regional inter-TSO compensation scheme, based on the setting of a regulated allowed revenue for each TSO and its coverage by tariffs raised by TSOs (*Regional entry exit tariff*). Such system would be neutral to TSOs' revenues and could in principle be extended to third countries, notably Switzerland and the Balkan Republics.

Discussion point 8. Do you agree with this proposal? Is any other solution to the tariff problem preferable?

3. Regulators of the region should agree on common *Guidelines for the treatment of new gas infrastructure*, including conditions to award exemptions from TPA rights after Article 22 of the Gas Directive, building on the work already undertaken by the Gas Regulatory Group for the Energy Community of South East Europe. Such guidelines would be based on awarding exemptions by a common regulatory decision for the whole infrastructure, in return for a fair capacity definition and reservation procedure, subject to predetermined rules and aimed at ensuring regulatory stability (open season).

Discussion point 9. Do you agree with this proposal? Is any other solution to the investment problem preferable?

4. Regulators of the region should define *common guidelines for balancing*, including the setting of balancing time units, tolerances and charges, and provisions for ex-post trading and or pooling.

Discussion point 10. Do you agree with this proposal? Is any other solution to the balancing preferable?

5. Regulators should develop *Guidelines of good practice on transparency and information management* at EU level especially addressing transparency requirements not sufficiently addressed in existing European legislation, as already undertaken for the electricity sector, however no specially harmonized provisions would be necessary on a regional basis.

Discussion point 11. Do you agree with this proposal? Is any other solution to the transparency issue preferable?

6. Member States of the region should ensure, their commitment towards a *consistent gas market regulation in the SSE*, as well as harmonization of regulatory powers in line with the Gas Directive and Regulation. Considering difficulties of gas market development in SSE, and SEE

such commitment may be sanctioned by adequate formal agreements including a regional Memorandum of Understanding, or some other form of *enhanced co-operation*, which may include provisions about minimum unbundling, reciprocity, gas release which may go beyond minimum provisions as stated by the 2nd Directive.

Discussion point 12. Is any special intergovernmental agreement between SSE countries, ensuing enhanced cooperation on a regional basis feasible and useful? Which issues should it cover?