

CEE gas markets

What rules should govern network tariffs, grid access and market balancing and who should ensure compliance?

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Setting the scene

A possible answer to this complex question could be summarised as follows:

Network tariffs should be governed by market rules in the supply/demand context; grid access through transparency provisions as already implemented; market balancing through interconnection agreements and global OBAs (Operational Balancing Accounts) between adjacent TSOs.

As regards compliance, it is/was of crucial importance to have regulatory authorities break up monopolistic structures. But after, it would be appropriate that they relinquish some of those regulatory powers, which are already covered by existing regulations, e.g. competition authorities.

However, the real world is not that simple and therefore the following paper elaborates on the issues from a TSO's perspective.

The EU's 3rd Energy Package has established some legal guidelines but there are many questions that remain unanswered.

So what is missing? It is not enough to say that gas transportation and storage needs to be liberalised via regulation. The reality is that we will have to deal with the current economic recession for longer than expected. In January this year, the "gas crisis" took the EU by surprise. The term crisis in this context is not strictly correct because the gas was there, but for political reasons delivery was a problem.

In the current economic and political situation, we need to question the timing and also the content of the 3rd Energy Package.

The new directives increase the regulatory burden on the market. Meanwhile, all stakeholders have to work

together to maintain a high level of security of supply in a more uncertain environment and to restore a climate of co-operation, which is essential for preventing or solving a future supply crisis. In this context, improving the relationship between the European Union and foreign producing countries and companies (e.g. Russia and GAZPROM) should be a priority.

EU Commission's proposals on effective TSO unbundling

According to Directive 2009/73/EC there are two "preferred" options for TSO ownership unbundling:

- full ownership unbundling or
- independent system operator

A third option as laid down in Chapter IV of the Directive is the Independent Transmission Operator (ITO). Considering the views of the Austrian representatives in the various Council working groups at the European Level it can be assumed that the ITO model will be implemented in Austria. The ITO model implies a high degree of regulation and as a potential ITO, we hope that regulation will be exercised with a degree of restraint.

For example, in our opinion "ITO" Chapter IV of Directive 2009/73/EC concerning common rules for the internal market in natural gas has to be assessed in terms of its impact on the vertically integrated undertaking. These provisions are very strict in order to avoid any positive discrimination in favour of companies within the integrated business. With respect to the relationship between the vertically integrated company and the ITO a strict approach is understandable, but the same approach should not apply for relations between the parent company and other market participants. Liberalisation rules should not go too far.

Chapter IV is not intended to undermine co-operation between TSOs and other market participants, which are not part of the vertically integrated undertaking. Therefore, existing business relationships of the future ITO (apart from those linked to the vertically integrated company) should not be touched by Chapter IV of the Directive.

To make the ITO model more restrictive than the ISO or Full Ownership Unbundling options should not be one of the outcomes of the 3rd Energy Package.

In the liberalised model, the network is controlled by an independent company, having no interest in the downstream market and the big question is: Will an unbundled network company have sufficient resources and sufficient incentives to invest in the development of the network?

Entry/Exit tariffs – Appropriate for all transmission systems?

A further, major reform with regard to the 3rd Energy Package is the creation of Entry/Exit tariffs or methodologies. According to Article 13 Regulation (EC) No 715/2009

“Tariffs for network users shall be non-discriminatory and set separately for every entry point into or exit point out of the transmission system. Cost-allocation mechanisms and rate setting methodology regarding entry and exit points shall be approved by the national regulatory authorities. By 3 September 2011, the Member States shall ensure that, after a transitional period, network charges shall not be calculated on the basis of contract paths.”

In Austria, tariffs for cross-border transportation are based on contract paths and, therefore, it will be necessary to establish a new system even though Austria is a typical transit country with domestic consumption considerably lower than the transportation of gas between neighbouring countries.⁶

An Entry/Exit system has many disadvantages. Not only will the tariff system need to be changed but also capacity allocation and calculation. An Entry/Exit System has no potential to create capacity – and balancing has to be redesigned.

Some advantages and disadvantages of an Entry/Exit system are as follows:

Advantages

- an Entry/Exit system is supposed to support competition to create flexibility in the network
- the fact that capacity at Entry and Exit points is marketed separately is considered to be a pre-condition for an increase gas trading

Disadvantages

- risk that short distance transmission prices are too high
- risk that transportation services are not priced to reflect costs
- risk of physical congestion
- risk that available firm capacity is reduced

Another issue is that complexity makes optimisation nearly impossible. For instance, how are costs to be shared? For example, the initiatives to invest in reverse flow capacities to deliver e.g. gas to Slovakia via the Austrian or Czech Grid. The Reverse Flow initiative is a step in the right direction but who will pay? From our point of view the transit shipper has to pay for such investment, but in an Entry/Exit system it could also mean that the domestic customer would also have to pay.

Top down approach or bottom up? Role of key stakeholders?

According to Regulation (EC) No 715/2009 Article 6, the process of establishing network codes is as follows:

- *“The Commission shall request the Agency(ACER) to submit to it... a non binding framework guideline (framework guideline) setting out clear and objective principles,... for the development of network codes relating to the areas identified in the priority list...”*
- *“The Agency shall formally consult the ENTSO for Gas and the other relevant stakeholders in regard to the framework guideline...”*
- *“the Commission shall request the ENTSO for Gas to submit a network code which is in line with the relevant framework guideline, to the Agency...”*

⁶ Austrian domestic consumption 2008: around 9 bcm
OMV Gas GmbH - gas transportation sold 2008: 66,32 bcm

These articles clearly define that network codes have to be devised by TSOs (within the framework of the ENTSO for gas) based on framework guidelines developed by ACER. The question here is does ACER have the competence to develop such framework guidelines or is input from ENTSO-G (and relevant stakeholders) required beforehand?

From a TSO perspective such guidelines can only be developed jointly. Therefore, neither a top down nor bottom up is the best approach – a combination of both would be the best solution i.e. close collaboration. This should be the role of the key stakeholders in the process – EU Commission, ACER, TSOs and national regulators.

Regional co-operation?

Regulation (EC) No 715/2009 Article 12 says

- “Transmission system operators shall establish regional cooperation within the ENTSO for Gas...”

In 2006, ERGEG established regional market initiatives and co-operation has achieved some progress in some regions but the results have not been outstanding. In the light of the 3rd Energy Package, these initiatives should be questioned. It would not make sense to maintain the Gas Regional Initiatives alongside the new ACER/TSO process.

The reality is that regional gas markets differ substantially – e.g. the North West market with various suppliers in contrast to the South East market with one dominant supplier – this difference is still ignored. We need to define an integration process which takes into account these differences.

Next steps

The central issue for TSOs is uncertainty surrounding the future return on investment. The aim of the regulators is to reduce tariffs but in the end the tariffs set could be too low to stimulate investment in networks. A reasonable return on investment is of utmost importance to guarantee network investment. Coming back to the question “What rules should govern network tariffs, grid access and market balancing in CEE gas markets and who should ensure compliance?” the answer is that the rules should facilitate:

- an appropriate framework for investment, capacity selling and balancing including sufficient incentives for TSOs and customers
- an improvement of the regulatory framework – stability and appeal procedures are just as important as standardisation
- the speedy implementation of the existing legal framework in ALL Member States
- a fresh approach to TSO co-ordination and standardisation for European transmission

