

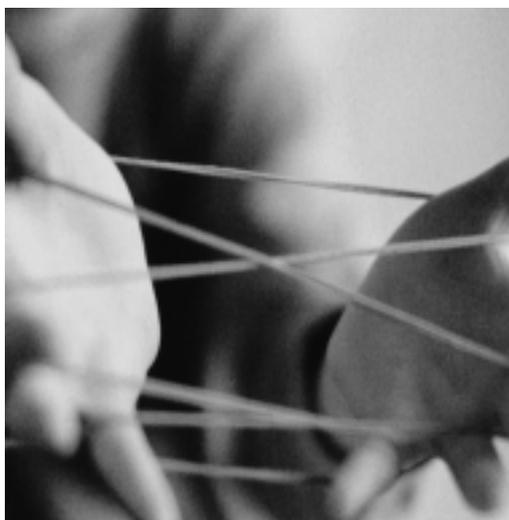
Need for a Regional Approach to Effective Competition

Eurogas, which represents the interests of wholesale and retail gas suppliers, believes that regional gas trading “hubs” will lead to greater wholesale market efficiency. Margot London, deputy secretary general of Eurogas highlights what needs to be done to create more effective competition.

Introduction – Setting the scene

Eurogas supports the achievement of the internal European gas market. A fully functioning internal market will enhance efficiency in the customers' interests and contribute to security of supply. Customer choice and effective competition will lead to the development of innovative, high-standard end-use services, and improve Europe's competitiveness.

Therefore, timely and correct implementation of the Directive 2003/55/EC concerning common rules for the internal market in natural gas and also of the Regulation on conditions for access to the natural gas transmission networks which came into force on 1st July (No 1775/2005) is necessary, as well as full implementation of voluntary commitments, notably the Guidelines on Access to Storage adopted by the Madrid Forum in Spring 2005.



Getting the complementary regulatory framework right presents a challenge. Therefore Eurogas participates actively in the Madrid Forum which seeks consensus-based solutions on the way forward. Eurogas also looks forward to contributing to the planned work of ERGEG on regional markets which can provide a useful next step to a fully integrated European market.

An essential framework approach should include:

- the assurance for suppliers of non-discriminatory access to the gas infrastructure system
- the development of market driven hubs
- the need to address any distortions arising from interactions between adjacent markets or network rules

Transparency and coherence of rules leading to convergence of operators' services will be keys to further progress, and contribute to well functioning wholesale gas markets.

An essential framework for non-discriminatory system access

From the suppliers' and systems users' perspective it is essential that rules are in place to ensure non-discriminatory access to pipelines, storage and LNG terminals, based on appropriate tariff structures. ►

Effective unbundling of transportation activities from gas trade is necessary to give users confidence their requests for network access and development will be treated in a non-discriminatory manner. Also there must be capacity allocation and congestion management rules to optimize use of existing capacity, as well as giving market signals for the development of new capacity. Suppliers must be able to move their gas through Europe in a fluid way on an economic basis.

Capacity allocation methods are of critical importance in ensuring a system of non-discriminatory access. In circumstances when capacity exceeds demand, there should be no problem with regard to acquiring capacity, but when demand exceeds availability of capacity then congestion management rules will be required that promote and support competition in the supply of gas, are not anti-competitive, and optimise the use of the system. In the first place it is important to incentivise a secondary market in capacity trading by capacity holders. Rules, however, should also involve clear Use-It-Or-Lose-It/Lend-It (UIOLI) rules for accessing capacity on an interruptible but also on a firm basis.

Meanwhile full implementation of the Regulation on conditions for access to the gas transmission networks should ensure the availability of shorter-term data to both market participants and authorities, which is necessary for the efficient and non-discriminatory use of the network.

The development of market driven hubs

Gas trading hubs need to be developed as a major element of the competitive gas market. While for suppliers, long-term

take or pay contracts will remain important and for most companies indeed will be the backbone of their supply strategies, it is necessary that a more liquid market is promoted, supported by shorter-term and spot contracts, and hub development, to complement longer-term arrangements, widen supply options by improving flexibility and enhancing portfolio optimisation. At the same time hubs can be a means by which a market value can be ascribed to gas used for balancing, and for contract indexation purposes.

At present a few hubs operate in Europe, but they vary considerably in terms of their trading terms, access to capacity, numbers of players, and whether or not they are regulated. Some are relatively well-developed; others are still in their early stages and have yet to develop the desired features of a well-functioning hub. Therefore Eurogas supports the work of the European Regulators Group for Electricity and Gas (ERGEG) to facilitate the emergence of properly functioning hubs.

The two key principles underlying an effective hub are transparency – that prices are public and available on a continuous basis and liquidity – requiring a sufficient number of willing buyers and sellers, and no single participant can exert undue influence on prices for physical trades, this liquidity also depends on the suppliers being able to move gas readily to and from the hub.

Successful gas hub development also depends on other factors. There should be fair access to transportation capacity around the hub, which should be sufficiently extensive to permit hub users to move gas to and from the hub. There should be a commercial and

regulatory framework, including standard agreements for hub services, which ensures transaction security and transparency of services. Although hubs should essentially be market-driven, their operation will require regulatory oversight of, for example, necessary technical and financial resources of players, verification of gas availability, daily operations and balancing rules.

Hubs can contribute to real efficiency gains in the market and to the more effective functioning of market competition.

Convergence of national systems

If an integrated European market is to be achieved it is also important to improve the compatibility and convergence of national operating systems so that transporting gas across Europe is a "seamless" experience for network users.

The principal responsibility of TSOs is to ensure the integrity of the system, and to deliver network's user's gas in accordance with the contract. As the market develops and indeed to facilitate the development of regional gas markets, the services offered by TSOs should correspond with the needs of system users, even if these needs can be expected to vary in different countries, regions, and at

different stages of market development. The development of entry-exit network access models should be pursued as they simplify transportation and balancing for users and support liquidity at hubs. Market based balancing should be an objective, as this would ensure that balancing charges are cost-reflective to provide the right incentives for users. TSOs provide at present different balancing regimes. It should be avoided that incompatibilities between different regimes lead to extra costs being imposed on users. Therefore possibilities for convergence between neighbouring balancing regimes should be investigated. This will be a main issue for the gas regional markets initiative.

Inevitably, some detailed rules and arrangements will continue to be different in different operating zones for some time to come. Therefore there has to be a common understanding on principles and objectives, and common definitions and as far as possible methods in a number of areas. For example, a commonly agreed approach on capacity calculation should underpin capacity allocation and congestion management. Rules on capacity allocation and to prevent capacity hoarding have to be consistently applied throughout the internal market. ►



Cross-border tariff systems have to be transparent and fair. There is need for progress in all these areas. Also gas and operational interoperability is a key area for action.

While this will require TSOs to co-operate more than at present, ways also need to be explored of improving the regulatory process. Regulators in all Member States have to enjoy full and equal independence. Especially as regulatory activities relate increasingly to cross-border activity, but additionally there has to be a greater level of regulatory co-operation and co-ordination, that will facilitate convergence and coherence of rules and regulators. The gas regional markets initiative has the potential to be a catalyst to minimise regulatory gaps.

Conclusion

Now that the basic building blocks of the wholesale market are in place, and once the legislation is fully implemented, the focus turns to identifying pragmatic solutions

to remaining obstacles to progress.

Voluntary agreements and consensus based approaches will be important instruments to improve the market functioning, and the overall framework approach has to focus on hub development. Releasing through specific measures and solutions the dynamism of regional markets, including pragmatic approaches on cross-border issues, will contribute to the successful achievement of the internal market.

This article has focused on wholesale market issues and internal market challenges. Eurogas recalls, however, that changes in the supply structure and considerations arising from world economic growth are bringing new significant challenges to Europe in respect of longer-term gas supplies. Not only must Europe remain an attractive destination for the world's gas supplies in the creation of the internal gas market considered here but external policy of the EU must equally contribute to ensuring security and reliability of supply. ■

