

transmission system operators more power to choose where the gas goes, and the need to strengthen gas infrastructure, to diversify gas supplies and thereby provide more competition in the market.

RSO May be an Alternative

The European Federation of Energy Traders (EFET), while believing that ownership unbundling would be desirable, takes a fairly pragmatic approach. It believes that an alternative to ownership unbundling should be put forward to improve the current system for cross-border trade. This could be in the form of "regional system operators" or a system in which national TSOs could "transcend" boundaries to be involved in decisions concerning investment in cross-border transmission capacity. This could mean merging TSOs in many cases.

Spot, Capacity & Cross-Border Trading

There was less agreement amongst our Expert Panel on the question of whether we would ever see a situation in the EU like in North America, where about 60% of contracts are for less than 12 months. Some panel members believed that political concerns over security of supply in Europe will make it difficult for short-term contracts to develop in the same way as in the US, while there was some doubt about whether a spot market could develop in Europe in the same way as in the USA, because of the small number of dominant incumbents in the EU. Conversely, others thought that with more flexibility in the market, there would no longer be the need for long-term contracts.

The issue of secondary gas capacity rights in the EU is also a key concern for the gas industry. The EU energy regulators group (ERGEG) believes that these markets are an important vehicle for capacity re-trading and therefore for providing access to gas markets within the EU. EFET produced a position paper on this subject on 29th March 2007 which states that the secondary market plays a vital role in helping market participants manage and shape capacity needs to meet business requirements, where the price of traded capacity is determined by agreement between

buyers and sellers. The paper set out a number of recommendations on how to promote greater secondary market activity, including "harmonised and timely platforms, coordination processes and information rights."

On the whole, our Expert Panel thought that there would be an increase in the trading of secondary capacity rights, largely because a general increase in trading will result in an increase in all products, including secondary capacity rights, and that this should produce more liquidity in the market.

There was less of a consensus on whether, gas release programmes are the best way of facilitating wholesale gas trading.

Although many of our panel believed that it was an effective mechanism, there was less agreement about whether this was the best way. In the same way, opinions were divided on whether long-term contracts made it impossible for third parties to access gas in upstream markets, although there was some agreement that these do indeed make it more difficult.

Cross-border trade in gas is a good way of improving liquidity in the market, but non-discriminatory access to cross-border capacity is an issue which still has to be resolved. New entrants are not able to compete on an equal footing with incumbents for access to cross-border transit capacity, and this acts as a barrier to competition. Coordination between national energy networks, in terms of technical standards, gas quality and congestion management mechanisms, is relatively low and needs to be improved if there is to be an integrated pan-European gas network. Such a network would facilitate investment in cross-border capacity, not only by the incumbents but also by new entrants. More investment in facilities and infrastructure would itself have the effect of improving liquidity in the market.

Some Signs of Progress

In the meantime, liquidity on the European wholesale gas markets is likely to remain low, although there are some positive signs which could have an impact in the short-term.

Wingas's decision earlier this year to merge its three gas trading zones in Germany into one from 1st October 2007, following similar moves by RWE and E.ON, should help to strengthen liquidity. Plans for Wingas to merge their trading zones with other gas companies later this year should also help to make trading more liquid. The

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increasing availability of LNG in the European market should also help to drive growth in wholesale gas liquidity in southern Europe, particularly as France develops more LNG terminals, and gas demand continues to grow in Spain and Portugal.

However, much will depend on the development of further EU legislation on the EU electricity and gas markets. The European Commission is expected to produce a third draft directive on energy liberalisation before the end of September 2007, and all market participants will await this document with interest •

* The survey is run in association with EFET and is conducted by **Moffatt Associates**: an independent market research and business strategy consultancy based in London.

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