The European Union of the Natural Gas Industry

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EUROGAS VIEWS ON A CONCEPTUAL MODEL FOR A EUROPEAN GAS MARKET

INTRODUCTION

Eurogas has welcomed the opportunity to engage in the consultation process on a non-binding gas market model. Eurogas responded to the consultations that were launched by CEER in January and July, and has also been active in the related workshops and bilateral discussions. Eurogas takes the view that a common understanding on eventual market design will be of added-value in ensuring consistency and coherence of implementation of the Third Energy Package, serving as a pragmatic steer on a level between the legislative framework set and the elaboration of new detailed market and technical rules. As the debate approaches its concluding phase, Eurogas takes the opportunity to pull together its views on the direction the model should take. These views adhere to the key principles of the approach that Eurogas has advanced throughout the different stages of the debate, but Eurogas thinking has evolved in the light of the exchange of ideas and useful argument in the last six months.

DRIVERS FOR A TARGET MODEL

Implementation of the Third Package throughout Europe aimed at a well-functioning integrated market remains a priority. The non-binding market model should be consistent with the objectives and existing legislation of the Third Package.

The target model should be consistent with and contribute to a range of energy policy considerations covering

- Effective competition and efficient market functioning
- Security of Supply
- Infrastructure investment
- A sustainable energy system, in which gas has an essential role to play
- Market integrity and transparency

The model should find a balance between necessary long term considerations to keep Europe an attractive market to suppliers at a time when global demand for gas is rising and the continuing drive to improve shorter term market liquidity and competitiveness in the interests of European consumers. The target model should also strike a pragmatic balance between issues to be managed nationally, regionally, and at European level.

The target model should not be inflexible but evolve as determined necessary by market players.

The work already underway, with deep harmonization of the market rules through the Network Codes should be the basis of the model. The successful conclusion and implementation of this work will determine well functioning markets.

Before final decisions can be taken, there has to be a clear understanding of the cost/benefits of eventual elements, and this should include the impact on the long-term commitments of gas suppliers, and future investment needs.

The legislative framework for market opening underpinned by harmonization and convergence of rules on capacity allocation, congestion management, balancing, tariffication, interoperability, has to be pursued as a priority, but target timetabling should respect the need for adequately framed rules arrived at on the basis of full

stakeholder consultation. The model should also look forward to the development of other Codes required by the Access Regulation, on which work is not yet underway.

Market integration, underpinned by improved cross-border connections and flows, should build on these foundations, and not be imposed artificially or prematurely.

In the light of these main considerations, Eurogas sets out in the Attachment the fundamental conditions and elements for effective market opening that should underpin the model. These include

- A well managed liquid capacity market
- Congestion management rules
- Market-based balancing systems
- Harmonized tariffication
- Interoperability

With these fundamentals in place, and delivering convergent operational practices, market integration will be more successfully developed. Eurogas supports **market-driven** integration of balancing zones (to market merger where agreed), and trading zones potentially covering more than one country can foster a faster development of the integrated market. But trading zones like balancing zones need to be **market-driven**, and not imposed on a top-down basis.

Market coupling, following the electricity model, is inappropriate for gas, but within-country or cross-border pilot interconnection schemes to bring markets closer together, should be encouraged, as relevant lessons may be learned.

CONCLUSIONS

Implementation of the Third Package remains a priority. The development of a Gas Target Model should focus first and foremost on establishing and implementing binding harmonized Codes in the key areas identified in the Access Regulation to deliver seamless interconnected markets. Therefore Eurogas would like the model to follow the current work on capacity allocation, congestion management and balancing, on the lines mentioned above, and also to address tariffs and interoperability. The basic legislative framework should be in place as soon as possible, facilitating market-driven development of optimally sized balancing regions and trading zones.

In addition, pilot projects - like a trading region based on the codes - in agreed action areas could be identified by 2012 and it would be useful if initial conclusions could be available for assessment by 2013/2014, taking account also of implementation of the codes A subsequent assessment should evaluate if the pilot is functioning to the benefit of market participants. Lessons may also be learned from pilot projects on market linking or trading zones. Such projects, however, should be market-driven, and set up on the basis of consensus among market players.

Therefore, consultation of stakeholders coupled with understanding of costs and benefits of any envisaged steps should be essential to the ongoing process.

CONDITIONS FOR EFFECTIVE MARKET OPENING

A well managed liquid capacity market

Unrestricted entry/exit systems allowing separate entry/exit bookings should be implemented.

The capacity allocation system aimed at maximizing the use of existing capacity should be auction driven, in a well-designed based on a cleared price mechanism for harmonized capacity products.

Shippers should have a choice of harmonized products, bundled transport capacities to incentivize hub-trading and separate entry/exit products at the flange. A well functioning market can be achieved by maintaining this choice and there is no need for an obligation to have bundled products as the sole products for shippers, with the risks and complexities that forced changes to contracts would entail.

It is essential to maintain the possibility of long-term capacity bookings for shippers, in line with the general recognition of the importance of long-term contracts in the supply portfolios of companies.

Procedures for determining additional or (new) capacity should be in line with the auction procedures for existing capacity. There should be regular assessments of future capacity needs, and there should be some sort of allocation process to give signals for future investment, conducted by the TSOs in parallel at different interconnection points. The eventual approach will need to guarantee a revenue stream for the TSOs and will require sound cooperation and coordination of not just TSOs but also regulators.

Congestion Management Rules

A well-functioning secondary market is the most efficient answer to avoid contractual congestion, coupled with UIOSI. If this option is not sufficient to solve congestion then consideration can be given to appropriately designed UIOLI on an interruptible and day-ahead basis, and over capacity/buy-back as an optional tool for TSOs, not an obligation.

Only as a last resort if these mentioned congestion management tools fail, should consideration be given to renomination right restrictions.

Market Based Balancing Systems

The eventual objective should be to have harmonized balancing systems across Europe.

Daily balancing with end-of-day cash out should be the target model. The preference for daily balancing notwithstanding, Eurogas considers the physical constraints of some transmission systems may mean that daily balancing is impossible in the short term, including for reasons of secure management of the network. In a few transmission systems the physical possibility and/or the cost of implementing daily balancing may also be prohibitive in the long-term. Where daily balancing is not possible for these reasons, the National Regulatory Authority may approve the use of a shorter period or a rolling period model in consultation with the TSO and network users.

An incentivized market-based balancing regime should be followed, that minimizes the role of the TSO and boosts the role of the network user. For this to work most efficiently shippers have to be informed of their balancing positions and the position of the whole market on a timely basis.

On a case by case basis, the regime may be permitted to include a range of within-day constraints or obligations that are appropriate to the local market, but these should not result in within-day imbalance charges.

Harmonized Tariffication

Tariff systems should not discriminate among users and should reflect the value of the service to the market. The tariff design should as far as possible reflect the cost to the network of the shipper using each specific point and give proper incentives to shippers to move towards an entry or exit points with lower costs.

The regulated tariff should be set as the reserve price for each kind of auction. This will avoid the risk of cross-subsidizing between different kinds of shippers buying capacities at different times, which could lead to an unwelcome and market distorting recourse to short term reservations.

Eurogas favours a regulated, yearly based, tariff pro-rated to the product's duration. Over and under-recovery should be minimized.

Interoperability

Technical, procedural, and operational interoperability are required. The scope of the Interoperability Code should cover harmonization of communication between TSOs as well as communication between TSO and shipper, and harmonization of units.

Rapid progress is also required in the area of harmonizing gas quality specifications as the large number of differing parameters remains a major obstacle for the integration of national gas markets into regional markets.

MARKET INTEGRATION

With the harmonizing elements in place, closer cross-border markets can be developed.

Market Zones

The determination of cross-border market areas should be market-driven. There should not be a deliberate policy of merging balancing zones. Zones should be expected to develop to their optimal size, not "created" beyond a level at which costs will outweigh benefits. It is a prerequisite that a balancing zone should have no capacity constraints. Appropriate involvement of DSOs should be addressed.

Trading Zones

This option to create trading regions covering more than one country may foster a faster development of the integrated gas market. It is essential, that infrastructure use and development, access conditions, and cross-border volumes promote growing liquidity and trading options at these newly created virtual points (VP). But the conditions need to be market driven, supported by harmonized rules set out in the Codes, and not imposed on a top-down basis. Furthermore the trading region option would leave DSO/retail business to develop mainly at a national level, a pragmatic approach.

Market Coupling

Market coupling following the electricity model is inappropriate for gas. Other forms, however, can be further explored as a means to link gas markets. It, responding to local conditions, within-country or cross-border pilots are developed to bring markets closer together, then these should be encouraged to go ahead as lessons may be learned relevant to future developments, especially with regard to the necessary differences between a possible market linking for gas and the established market coupling in electricity.