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BY PEOPLE FOR PEOPLE

BEE Energy Management & Trading

European gas regulation : a balance yet to find between market integration and market attractiveness

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Energy Europe

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European Regulatory framework
a long term process

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3rd energy package directive (July 2009)

- Defines high level principles (third party access, basic rules for tariff, capacity allocation…)
- Defines unbundling rules for TSOs (in force by 3rd March 2012*)
- Defines transparency requirements
- **Lists 12 network codes to be written by ACER & ENTSOG** ← *focus of this presentation*
  Supposedly technical texts, but with huge impacts on gas business activities

The February 2011 European Council sets 2014 as the deadline for the completion of internal market. Confirmed in March 2012 European Council

CEER** proposes a non binding, high level vision, the Gas Target Model, built from economic papers to give a general framework to the network codes.

- "A set of **entry-exit market zones** with their own virtual hubs connected through a limited number of bundled capacity products identical all over the EU and allocated via auctions"
- A vision **focused on short term hub to hub exchanges**

* 3 March 2013 if network owned by a non European country
** CEER is an association of regulators, created in 2000, a non official equivalent of ACER

Focus on network codes
Technical texts/process with strong business impacts

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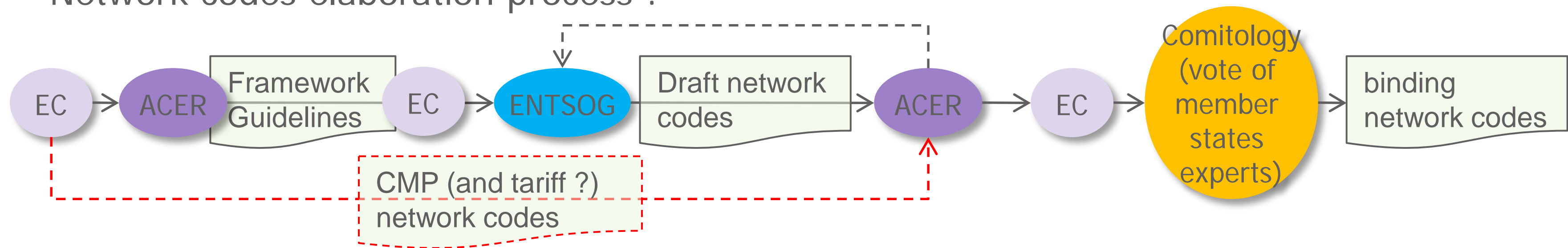
- Network codes elaboration process :



ACER (Agency for the cooperation of Energy Regulators) : European commission body

ENTSO-E/-G (European Network for Transmission System Operators) : TSO association

TSOs has 12 to 18 months to implement Network Codes.

In this process, **Commission can hold its position even against an industry consensus, as only a majority of member states experts can veto a proposition**.

Level of advancement of codes currently under study

- Congestion Management Procedures (CMP) → adopted
- **Capacity Allocation Mechanisms** (CAM) → on going Comitology (last meeting April 15th)
- Balancing → Draft by ENTSOG, comitology mid 2013
- Interoperability → Framework guidelines (comitology)
- **Tariff** → Scoping (on going framework guidelines)

Capacity Allocation Mechanism Code overview
At the core of the new market design

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- **Core of the code : synchronized auctions across Europe + bundling of capacity**
  - 15 years auctions – yearly products / yearly auctions – quarterly products / monthly auctions – monthly products / daily auctions – daily products / within day
  - Reserve price = tariff
  - At least 10% to be auctioned year ahead in quarterly products
  - At least 10% to be auctioned over 5 years in yearly products
  - Mandatory bundling and sunset clause

  } **Applies to new capacities**

- **LNG & storage accesses, supply-only network excluded. For third country IPs, subject to National Regulatory Authority decision…**

- **Status : on going comitology process (i.e. vote by Member States expert), last meeting 15th April**

Mandatory bundling and sunset clause

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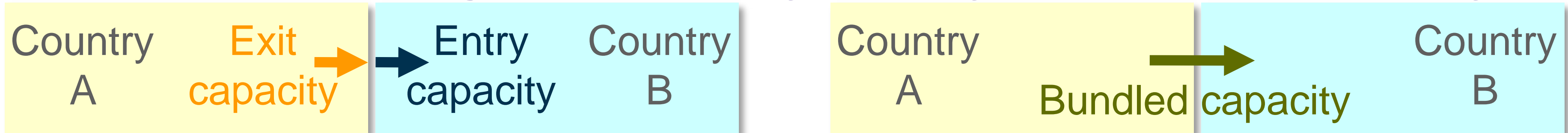
- **Principle : to merge exit and entry capacity in one bundled capacity**



  - Mandatory bundling : all newly booked capacity shall be booked bundled
    Sunset clause : bundling of already booked capacity
  - EC objective : to foster hub liquidity by removing trading "at the flange" and by concentrating trading at hub
- **Many major issues for no proven gain :**
  - Sunset clause breaches existing contractual rights and threaten long term supplies contracts by imposing a change of delivery point
  - Mandatory bundling destroys capacity / flexibility at complex points (Y points, German point to point capacities…)
  - As capacity often does not match on both sides of the border, there remains stranded unbundled capacities than can be totally useless, but still to be paid…
  - local suppliers in charge of security of supply may no more physically nominate at borders but only at hubs ➔ how to ensure security of supply with less ability to forecast physical flows ?

Despite these issues acknowledged by all industry, Commission is still holding on mandatory bundling

Issues linked to mandatory bundling : Y points example

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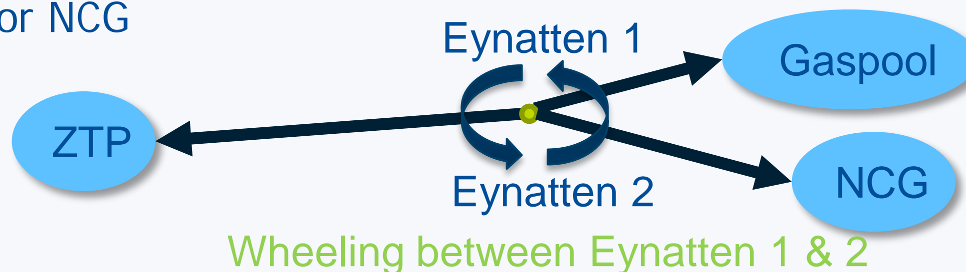
- Current solution allows to maximize flexibility through the payment of a wheeling service : shippers can maximize their use of Eynatten capacity depending on the gas need in Gaspool or NCG



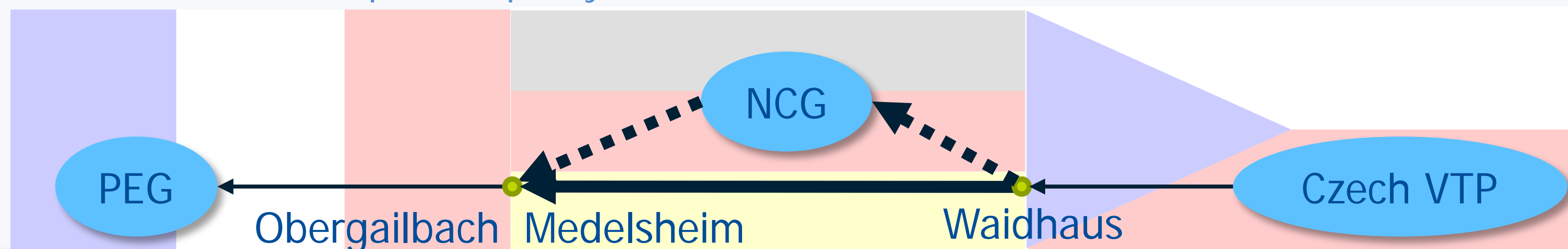
- With mandatory bundling there would be a **loss of flexibility** : if a shipper booked Eynatten 1 capacity and he would have an exchange need with NCG, Eynatten 1 capacity will remain empty while additional capacity on Eynatten 2 would have to be booked. This allocation is thus less efficient.

Moreover, whereas capacities are firm on Belgium side of the border, capacities may be partially interruptible[1] on German side : **mandatory bundling can impose fully interruptible capacities at Eynatten**

[1] This interruptibility issue is described hereafter

Issues linked to mandatory bundling :
German point to point capacities

- Current dZK solution allows some flexibility : from Waidhaus, firm capacity to supply France, and interruptible capacity to access NCG



- With mandatory bundling :

1st option : an interruptible chain threatening French Security of Supply and degrading existing contractual rights : **up to 62% of previously firm entry capacity (~10 bcm/year) is made interruptible[1].**

2nd option : a firm chain with no German access, considerably restraining market liquidity, opportunity to find alternative sourcing in case of upstream curtailment, and creating major inter TSO revenue issues : **~10 bcm/year of interruptible capacity from Waidhaus to NCG is suppressed[1].**

3rd option : to suppress BZK, dZK, bFZK products, requiring huge investments, probably of the order of magnitude of NCG –Gaspool merger (3 G€)

[1] : these figures correspond to the case of an immediate bundling of all commercial capacity, irrespective of their contractual status

Tariff Code overview
Can become key in the new market design

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- **Short term inferior or proportional to long term price of capacity should not be retained :**
  - It will trigger a "flight to the short term", acting as a disincentive for further investment in the networks.
  - It will create huge under-recovery for the TSOs, that will have to be recovered. In the UK, it resulted in a high and unstable commodity charge, that is a barrier to trade and a cross-subsidy from long term shippers to traders.
- **Repartition between entry tariff, exits towards other zones, and customers delivery :**
  - Cross subsidization between transit and domestic flows should be avoided
  - A rigid rule would disrupt most existing tariffs, creating endless claims and further increasing perception of regulatory risk on existing long term commitments
- **"Incremental" capacity : balance to be found between**
  - stimulating capacity development (lower % of long term bookings required before FID, additional financing expected from short term future bookings)
  - avoiding stranded capacity and so socialization of costs (all financing secured by upfront bookings)

Tariff discussion is still at an early stage (framework guidelines on-going) : new issues may arise

Conclusion

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- **Industry has not been heard on adverse consequences of mandatory bundling.**
  How to efficiently convey this message (last comitology meeting on the 15th of April) ?

- **Keeping long term capacity prices under short term prices is key to define a sustainable market design.**