



# **Developing a roadmap towards a single competitive European Gas Market**

An introductory paper from EREG for the Madrid Forum

**Ref: E05-SEM-13-03**

**2005-09-09**

### ***The need for a gas ‘road map’***

1. Despite considerable progress towards achieving a single European market for gas, this remains some way off. The long-term vision is clear: effective competition delivering real benefits for gas consumers throughout the EU; a stable regulatory framework facilitating sustainable levels of investment; secure supplies; choice; and gas suppliers able to market their services to all consumers across the EU.
2. With few exceptions, effective competition in Europe is still limited. There is a small number of gas exporters supplying Europe, some of which have monopolies. Commercial incentives may therefore be to hinder development of effective gas-to-gas competition within Europe. In addition, North Sea gas production is declining. However, the long term vision, including the availability of new sources of gas supply to Europe—notably LNG—remains valid. Its objective is to foster real supply-side competition (ie, in a given location, gas available from a range of competing suppliers), entry–exit tariff arrangements for access to transmission networks, and liquid hub-based trading.<sup>1</sup>
3. This paper introduces the work that ERGEG is undertaking to take stock of progress and to develop a ‘roadmap’ for finally achieving a single European market for gas. This introductory paper does not, however, draw conclusions on the way forward. The roadmap will examine progress to date and the present state of competition; identify remaining barriers to achieving the goals of the long-term strategy; and take account of the dynamic nature of competition within the market and recent changes in market fundamentals (notably LNG). It will also identify priorities and options for action. In developing the road map paper careful analysis will be needed to identify priorities for action, and to describe practical steps towards the longer-term goals.
4. Consultation with industry and other interested parties remains crucial to ensure that all significant problems are identified and tackled in order of priority. We will particularly welcome examples from industry participants of problems experienced in European gas markets, which are obstacles to progress towards the single European gas market.

### ***Current legislative and regulatory framework***

5. It is crucial that the long-term strategy is supported by a legislative framework that sets out the rules for the operation of the market. Full implementation and effective enforcement of existing legislation in all Member States is a prerequisite for achieving a single European market for gas. There is much to be done.

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<sup>1</sup> These goals were described in *A long-term vision of a fully operational single market for gas in Europe – a strategy paper (draft)*, Joint Working Group of the European Gas Regulatory Forum (2002).

6. Moreover, the current legislative framework does not address everything required for the establishment of a single market. Arrangements for access to storage, investment in cross-border infrastructure, tariffs for cross-border transportation, and information/transparency are not fully covered in detail by the current legislative framework. Concerning access to gas storage, regulators have developed voluntary guidelines for storage operators, but these arrangements have not been in place long enough to tell whether they will be effective.

### ***Progress towards the goal of the long-term strategy***

7. There has been progress towards the long-term goal: for example, hub-based trading<sup>2</sup> continues to develop across Europe; third-party access to storage facilities has improved; and investment is bringing new sources of piped gas and LNG to European markets.
8. More specifically, significant problems can already be seen to be present in the following areas of policy.
- Although hubs have developed in several markets, trading is not yet liquid, and there are many markets where hubs have not yet developed at all. Access to, and availability of, transportation capacity to and from hubs can also be problematic. Contractual and physical flows remain closely linked.
  - Where there is sufficient transportation capacity, gas may be unavailable for contractual or commercial reasons, thereby preventing liquid trading from developing.
  - The existing legislative package has gone some way to providing non-discriminatory third-party access to pipeline capacity—which is essential for effective competition. However, cross-border trade may be hindered by insufficient capacity being made available and by some legacy contractual capacity booking provisions to which the Gas Directive does not apply (eg, there may not be effective Use-It-Or-Lose-It mechanisms or secondary trading). It may also be adversely affected by interoperability problems between adjacent systems, and by tariff issues (under the new gas Regulation, the degree and level of detail to which tariff principles should be harmonised to avoid distorting cross-border trade needs to be assessed). Arrangements for ensuring investment in sufficient cross-border transportation capacity may not be in place.
  - Competition in European gas markets would be improved through greater transparency and better management of information by TSOs.
  - Market structure and concentration, including upstream outside the EU (where some gas exporters have monopolies), presents a threat to effective competition. In particular, it remains to be seen whether unbundling of integrated companies is

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<sup>2</sup> a hub is a physical or notional reference-point within a network at which liquid trading can develop because the hub is well connected to multiple sources of gas supply and demand

effective enough to ensure non discriminatory access to infrastructure. Given this situation, the benefits of gaining access to new supplies, and the importance of market rules supporting competition between suppliers, are clear. New supplies could provide competition upstream, as well as a source of gas for new entrants wishing to compete downstream. The sectoral inquiry by DG Competition will also be important.

- Some progress has been made through voluntary guidelines (for example, the Guidelines on Good Practice for Storage System Operators), and this approach could be followed in other areas (eg, transparency). It is too early to say whether compliance under such an approach can be effectively monitored and enforced.
- Gas quality issues may restrict cross-border trade if adequate treatment facilities and appropriate mechanisms for access to them are not in place.

### ***Way forward and timetable***

9. There is a clear need to set priorities, and to set out a defined programme of work for dealing with these and other issues. ERGEG intends to publish a draft roadmap for consultation later this year. Having considered the responses to its consultation, ERGEG will publish a final version of the roadmap in early 2006. It will set out in detail ERGEG's views on priorities and the appropriate way forward. At this stage, however, possible mechanisms for making progress can already be outlined.
10. There will be strong regional elements in identifying practical solutions. The necessary analysis will be carried out with a technical focus, to examine in detail the barriers to further progress within each region, and to develop solutions, with the gas industry and other stakeholders' participation.
11. Solutions developed on a regional basis must, however, take into account the goal of a single European market for gas, and progress towards regional markets must not themselves throw up barriers to trade between regions. Work on the 'horizontal' principles common to all regional markets will be taken forward in parallel.
12. These regional case studies will concentrate on two aspects of market development: trading at hubs within the regional market, and hub-to-hub trading within and between regional markets. EU gas hubs are at different stages of development—in some regions some bi-lateral trading does take place, but liquid and transparent hubs have not appeared. Lessons can be learned about each stage of this development, and solutions identified that are appropriate to particular regions. The case studies will then set out what needs to be done to facilitate trading at hubs within each region, and trading between hubs within and between regions. They will also examine experience of the development of existing successful hubs; access to capacity into and out of hubs (including capacity trading); incentives for investment in transportation capacity between hubs; information and transparency; availability of gas sources;

communication and transaction arrangements; cross-border compatibility (eg, of balancing and flexibility regimes); cross-border capacity; the arrangements for regulatory oversight (including of unbundling measures on pipeline systems crossing national borders); and the existence of regulatory gaps relating to cross-border activity. The focus will be on revealing the practical issues that are most important to the further development of effective competition within each region.

13. Common principles are also needed—to ensure that the approach taken at a regional level remain consistent with the longer-term vision of a single European market for gas. A key issue here is gas quality, since rules that relate to gas quality and access to relevant treatment plants have the potential to restrict trade across Europe as a whole (and in some regions different networks in the same area contain gas of different specifications). A comprehensive list of topics on which common principles will need to be developed will be set out in the roadmap consultation.
  
14. The barriers to further progress will be overcome by a combination of actions by various parties. This could include monitoring of compliance, both with *ex ante* regulation and *ex post* competition law, and enforcement action where necessary; greater transparency of TSO actions, especially important where there is not yet full ownership unbundling; development of regulatory guidelines; more effective co-operation between regulators and between TSOs; and further legislation at national or EU level if regulatory gaps cannot otherwise effectively be filled. A competitive single European gas market needs full implementation and enforcement of existing and future legislative measures. Currently the powers of regulators vary widely which restricts their ability to play a full part in this crucial area.