

GIE reaction to “Energy Regulation: A bridge to 2025” paper

The CEER Vision for a European Gas Target Model stated at the end of its Conclusions Paper (1 Dec 2011) that “the model should be evaluated and if necessary further developed after the implementation of the network codes on capacity allocation mechanisms, gas balancing, harmonised transmission tariffs and gas interoperability in 2013 as well as in the light of the work on incremental capacities in 2012 and their practical implementation “(...)”.

GIE agrees with the above mentioned conclusions, and wishes to underline the successful joint efforts which are being taken by stakeholders to ensure the (early) implementation of the above mentioned framework. Apart from the CMP network code, partially implemented in October 2013, work on the implementation of other network codes has just started or will commence soon. A review of the Gas Target Model before the adoption and full implementation of the codes seems therefore premature. The focus should be on implementing the agreed rules, with significant progress expected to be achieved in a short term period. The need for additional measures should be considered after two to three years based on the experiences with the new market rules.

GIE would furthermore like to stress the fact that electricity and gas markets are quite distinct. Measures aimed for integrating the electricity markets do not necessarily provide workable solutions for the gas market. To avoid damaging consequences for the gas industry, remedies proposed for the gas market should be targeted to address identified shortcomings in the gas market and not be cloned models from the electricity sector. However GIE would like to play a part in the dialogue on how the gas sector could help balance an electricity sector increasingly based on fluctuating renewable production.

Notwithstanding the above, GIE wishes to further outline the following aspects raised in the discussion paper:

- **Gas specific strategic context and demand for gas :**

The paper seems to assume that in any conceivable scenario gas demand will go down. GIE acknowledges that the gas industry is currently facing reduced demand, mainly linked to the economic crisis in Europe. In addition several other factors impact European gas demand such as shale gas production in United States and as a result low coal prices, higher average winter temperatures in recent years and surging LNG price with cargoes going mainly to Asia.

GIE is however confident of the essential role that gas and gas infrastructure will play in the future, especially considering the significant and timely contribution it can bring to a sustainable, secure and competitive energy market.

By substituting coal and oil fired power plants with gas fired power plants, a quick reduction of greenhouse gas emissions can be achieved against low capital expenditure. Gas and gas infrastructure are vital for securing energy supply to European customers, not only for direct gas consumption but also for electricity production. Furthermore, gas infrastructure enables innovative low-carbon technologies such as power to gas or compressed air energy storage (CAES).

Moreover, gas, in the form of CNG or LNG, provides opportunities for reducing carbon emissions in the transportation sector. And gas enables renewable sources, not only wind and solar energy, but also gaseous renewable energy sources such as biomethane, with a substantial potential for further development.

Notwithstanding any gas demand scenario, a European policy framework is required that enables the development of gas, as the cleanest fossil fuel; now, in the medium and long term. Given the fact that gas infrastructure investments have long lead times and long depreciation periods the industry needs clear and positive signals on the role that gas will play beyond 2030. A stable and predictable regulatory framework, providing fair remuneration of the assets is crucial in this respect. The regulatory framework should also enable long term commitments, from the users and/or regulators, as an essential part of the gas market. Therefore GIE regrets that the Framework Guidelines on Tariffs does not provide any incentives to shippers to book on a long term basis, which could be to the detriment of new investments.

Shortcomings in the current energy and climate policy should be urgently addressed. A redesign of the ETS system is needed so it can play its part in incentivizing low-carbon investments. Multiple energy and climate targets and measures should be avoided to prevent overlapping policies which lead to contradictory results; moreover, subsidies should be limited to the development of immature low carbon technologies.

- **Investments**

The market can provide the best investments signals. Top-down centralized investments planning could lead to higher societal costs. Requirements of the regulatory system as outlined above are crucial to ensure that new investments will materialize. Some investments which are not based on direct market demand (such as for security of supply, sustainability, etc.) might need some targeted support to ensure implementation. The TEN-E infrastructure regulation and the Connecting Europe facility already provide measures for the implementation of these projects. However, it should be ensured that these projects do not hinder or jeopardize the value of the existing investments.

The crucial role of infrastructure to enable a well-functioning internal market has to be ensured. Whereas insufficient infrastructure capacity may have an impact on prices and security of supply, redundancy of capacity may have a negative effect on the competitiveness of the gas vis-à-vis other energy sources. Therefore an optimum should be found that would limit additional costs while enabling market integration.

- **Competitiveness and integrated wholesale markets**
 - **Market integration :**

GIE and its members are committed to establishing an integrated internal energy market. A recent study from Booz & Co. on behalf of the European Commission estimates that the benefits of full market integration could add up to a maximum potential benefit of €30 billion per year for the whole European Union, provided that the current situation of oversupply continues.

While not wanting to diminish the positive effects of further market integration, GIE has some concerns with the conclusions of this study. The €30 billion per year does not include any costs, and in particular, any depreciation costs linked to the needed investments in infrastructures to enable the fully integrated internal market. To achieve this high level of market integration, substantial investments would be needed (far above the investments currently included in the TYNDP). Benefits of integrating markets should always be set against the costs. Therefore, this figure of € 30 billion per year is misleading.

Moreover, the assumptions and calculations made in this study would benefit from being reviewed and validated by the stakeholders before drawing any conclusion. GIE would furthermore like to highlight that there has been no consensus on the results of this study.

Concerning the evaluation of the existing Gas Target Model and the measures of functioning markets, GIE notes that ACER promotes CEER's criteria for competition, which imply that many of Europe's current entry/exit zones would be required to merge to meet the criteria. It should firstly be noted that the adequacy and appropriateness of that criteria was not rigorously established. There are definitional issues that mean that data will not be strictly comparable (for example there is no accepted definition of churn) and furthermore a zonal demand of less than 20 billion m³ or churn of 8 represent somewhat arbitrary values for the assessment. The criteria should therefore be regarded as indicators only, and any consideration on mergers of market zones should include a proper cost-benefit analysis, taking local circumstances into account. When mergers of zones involve crossing national borders, this can even cause additional problems resulting from different national legislations (such as fiscal, financial or regulatory matters). The KEMA study made on behalf of European Commission has indicated, in the cases of mergers which were studied, that the benefits were not as important as expected. GIE therefore encourages case-by-case studies and considerable stakeholder dialogue on this issue.

- **Liquidity of hubs**

GIE considers that liquidity at all hubs is not an objective per se. It is sufficient that some hubs are liquid, and that the others are priced with a basis differential, unless there is inadequate capacity - also taking storage and LNG terminals into account. We already observe a relevant level of correlation among a number of hubs in Europe which is a very good signal, as confirmed by the OIES study and ACER's own market monitoring.

Moreover, there is also a need for better market functioning in Central and Eastern Europe, which is suffering from a lack of upstream competition and from insufficient interconnections to Western Europe. It should be noted that adequate interconnection between markets will help reduce regional variation in prices.

- **Flexibility of gas plants to support RES generation**

Gas fired plants need to be very flexible. The impact of their sudden gas offtakes can put the management of the gas transmission network at risk. GIE considers that the coordination of intra-day balancing gas and electricity markets should be reviewed in order to ensure that the integrity of the system is ensured, that the security of supply is warranted, and that there is no cross-subsidy between network users. In this respect, special attention should be paid to possible regulatory barriers hampering the interaction between the electricity and gas markets before introducing new regulatory measures.

Considering that significant improvement is expected through the implementation of network codes, GIE is of the opinion that the scope of the “bridge to 2025” should primarily be limited to the following areas: better coordination between ACER and European Commission initiatives in order to design a better investment climate; inclusion of renewable gas in the market model, better coordination between gas and electricity markets; a search for price convergence and correlation among hubs at reasonable costs; a reflexion how to ensure that investments are made where they are the most needed while maintaining gas competitive and avoiding the risk of stranded assets.

GIE will remain a committed player in this dialogue.