January 2017
17GIE001

GIE response to Invitation for written comments:

"Quo Vadis EU gas market regulatory framework? – Study on Gas Market Design in Europe"

Introduction

The Commission will launch a study under the title *"Quo vadis EU gas market regulatory framework – Study on a Gas Market Design for Europe"*. The aim of the study is to provide substantiated analysis as to whether the current regulatory framework in the EU gas sector is the most effective in order to maximise overall EU welfare or whether amendments may be necessary, and if so to provide recommendations. The study will be launched early 2017 and run for 6 months.

Tenderers were invited to include in their proposal a discussion paper of 5-10 pages setting out their vision of an ideal EU gas market regulatory framework. These discussion papers will serve as input to the study and as a basis for discussions.

Following the DG ENER's invitation to send written comments on the discussion papers prepared by the tenderers, GIE is glad to contribute with this document.

GIE vision on an ideal EU gas market and its regulatory framework

GIE believes that an ideal gas market should ensure that energy is delivered at minimum social cost, enabling effective supply competition and market integration, delivering security of supply in a cost-effective manner and ensuring that the costs linked to the implementation of any regulatory framework changes are offset by the benefits provided. Aspects such as industrial competitiveness, sustainability and interaction of gas and electricity should be duly taken into account when finding such an optimal framework. We believe that flexible regulatory arrangements would also help to future-proof the market, ensuring that the regulatory regime is agile enough to allow market participants to respond to changing market conditions.

Gas infrastructure operators active in transmission, storage and LNG business are "market facilitators", enabling an effective supply competition, and ensuring a safe supply of energy to the final consumer. GIE believes that gas, whether renewable or natural gas, and its gas infrastructure will have a key role in a low carbon sustainable energy system and in the transition towards such an energy system.

Gas Infrastructure is crucial to make the energy transition affordable, the role of gas infrastructure will be determined by what's needed to make our economy CO_2 neutral. We embrace the commitment of limiting temperature rise to a maximum of 2 °C, pursuing efforts to towards 1.5 °C as set by COP 21, with gas infrastructure as a crucial part of this commitment. The gas infrastructure system can transport and store large quantities of energy, also across borders in a cost-efficient and affordable manner. This infrastructure should be used in a manner which maximises social-welfare benefits and reduces investment needs in the energy transition. In particular, massive investment in the electricity system, while on the other hand stranding the gas transmission system should be avoided if one wants to keep the social cost of the global energy system at the lowest level possible.

GIE believes that the main aspects of an ideal EU gas market are:

Towards a European energy system maximising synergies

The recent Madrid Forum (October 2016) indicated that there is little support for major changes of the gas market model. However, changes introduced in the context of the 'clean energy for all Europeans' package, notably on the governance of the electricity market, its market model and power generation could also have consequences for the gas market. An effective market design makes sure we reap the benefits from synergies between the gas and the electricity market to optimize the socioeconomic benefits of an integrated energy system within the context of the energy transition.

In the future, the energy sector will be more decarbonised, decentralised, digitalised and new players are expected to get into the market providing new services and options. This will require flexibility which gas infrastructure can provide, with gas as an energy carrier, be it from biomethane, synthetic gas (obtained through Power-to-Gas technology), or natural gas for specialized applications (e.g. high temperature industrial processes).

Making use of existing infrastructure

In order to maximize social welfare and keep the costs of energy transition low, regulatory requirements in a future regulatory framework should not risk the business cases of existing infrastructure, as the gas system plays a key in the decarbonisation of our energy system.

Allow energy to flow freely across borders

An effective gas market is defined in the updated GTM: This vision is of a competitive European gas market, comprising entry-exit zones with liquid virtual trading points, where market integration and diversification of supply are served by appropriate levels of infrastructure, which is utilised efficiently and enables gas to move freely between market areas to the locations where it is most highly valued by gas market participants.

Currently, the European gas market is strongly evolving towards that vision: hubs in North-West Europe are becoming more and more mature, resulting in an increased price convergence of the gas markets, and the realisation of the first market integrations becoming a fact (e.g. Belgium-Luxembourg). These developments should become more visible in the rest of the EU, especially the peripheral countries, during the upcoming years. As such, we have made already great progress on most of the objectives of the 3rd Energy Package throughout Europe.

Allow energy to flow freely across sectors

In order to further develop the most efficient European energy market there will be a need for increased horizontal integration across the energy sectors. The gas regulatory framework should be developed to allow the gas sector to set up stronger links with neighbouring sectors (e.g. power, heating, transport, etc.) in order to allow energy to move easily across those sectors according to market needs and energy policy targets.

The gas and electricity markets are part of an overall energy system. The regulatory frameworks should be compatible, while respecting the fundamental differences between gas and electricity. For instance, the proposed revision of the Directive on the Electricity Market (2009/72/EC) as part of the

Clean Energy Package, published on 30 November, does not allow electricity TSOs to own, manage or operate energy storage facilities or directly or indirectly control assets that provide ancillary services. In the gas sector, a competitive storage market exists, where infrastructure operators (TSOs) offer competitive services to consumers. This model may serve as an inspiration when shaping electricity storage markets, where new technology has to be taken into account. In order to ensure optimal utilization and enhance competition amongst existing flexibility providers, any regulation should avoid unnecessary costs and impose a similar regulatory framework towards a level playing field.

Similarly, the impact of restrictions for electricity TSOs in providing storage services have to also be closely examined for promising technologies in the gas sector, notably electricity storage in the form of hydrogen (electrolysis). As this illustrates, the impact of regulation needs to be considered on the overall energy system, and should enable competitive markets, especially for upcoming technologies.

The investment process should be adapted to the market circumstances

Within the EU there are gas markets with different levels of maturity, development, penetration of gas, liquidity, connectivity, security of supply and market integration. Despite good progress we still see a need for further investment activities to connect and diversify certain gas markets in the EU. Uncertainty about energy policy and regulation and its lack of coordination at EU level as well as uncertainty about the development of future gas demand can be seen as a barrier to long-term commitments by market players.

The ideal framework should bring a mechanism to trigger investments on projects which clearly increase the social welfare of the consumers, while fulfilling energy policy objectives. The alternative might be a lack of investments even where there are clear socioeconomic benefits. A financial solution should be found to fairly share the risks associated with this uncertainty between consumers and investors. In order to select investments, a CBA might be an appropriate tool to address some of these uncertainties in specific regions. This might also involve adaptions in the PCI selection process.

Due to the long term unpredictability on future gas demand and gas flows, new infrastructure needs a realistic timeframe for recovery within the tariff cost structure. Given the likelihood of lower load factors, but still high flexibility needs, this may entail shorter amortisation periods or other equivalent solutions to ensure a fair rate of return for investors. The provision of such flexibility requires adequate financial compensation.

Establishing cooperation across the value chain

In the same way as horizontal integration may provide benefits for the entire energy market, improved vertical cooperation may also provide increased value for the consumers.

DSOs and TSOs need to build a constructive and cooperative relationship. Information exchange between DSOs and TSOs should encourage better planning and ensure better management of the networks.

Promoting innovation, new services and initiatives

In recent years the gas sector has demonstrated its ability to innovate and develop in line with the developing trends of the entire energy sector. Gas infrastructure operators are playing a key role in this regard when it comes to cooperating with key players on P2G, bio-methane and gas for mobility.

This change may lead to the development of additional ways that the gas market can support the development of a more climate friendly energy system, reducing emissions and providing better air quality.

As a consequence a new market design should help provide a framework that helps nurture the use of these new technologies until they reach commercial maturity and wide deployment. The TSOs are welcoming these technologies but the incentives to expand their use significantly are currently outside the realm of the TSOs. Infrastructure operators are a crucial part of the gas value chain and should therefore take a role as market facilitators.

Infrastructure operators should be allowed to develop their own business related to gas infrastructure and generate additional revenues in addition to their current regulated tariffs, respecting the provisions of the 3rd Energy Package. The gas industry is innovative, and continues to have a great potential to develop new technologies which benefit our society in the energy transition. Emphasis should be placed on the deployment of the latest results of research and innovation activities, while bringing innovative projects to the market. This should also be fostered by policy makers, for example by allowing new market or business models. This includes technologies such as power to gas to convert excess renewable electricity to hydrogen or synthetic methane, or gasification technologies to convert biomass to renewable gas.

Feedback on the Main Points raised by tenderers in their discussion papers

GIE noted how the tenderers have outlined their own independent visions on how the gas market should look like. There are well developed visions on which the study should be built.

The study should emphasize on an understanding of wholesale markets and the drivers of these markets: What are the characteristics of the current markets, how is competition manifested in those markets and what are their results for welfare?

Besides what has been said above, GIE would like to comment on specific proposals made by some of the tenderers in their proposals:

Topic 1: Market mergers – a single EU market area

Some stakeholders are suggesting to introducing an EU single market area with entry/exit tariffs on EU border points and the removal of tariffs from intra-EU interconnection points. Currently, this is not a realistic model, given that a number of preconditions are not me. Most notably, governments, NRAs and markets have to be fully committed, bearing in mind the significant (financial) implications as well as its effects on commodity prices and for certain market parties to the detriment of others.

Market mergers should be only undertaken if the net-benefits outweigh the net-costs and they should not be mandated through a top-down, regulatory approach. The aim should be to ensure market integration and diversification across the EU. Full market mergers are not always the best tool to achieve this. They should rather be perceived as one potential option towards well-functioning gas markets. What needs to be addressed are the existing barriers (physical, commercial, regulatory, political etc.) to market integration. The implementation of all NCs across all EU Member States will help to remove some of these barriers. In some cases market integration may be the best solution in order to merge areas resulting in a single price and more efficiency. In other cases it may be more value adding to develop well-connected hub to hub competition that helps provide information to market participants. The steps considered should reflect both the stage of development in which the relevant infrastructure is as well as technical and market based realities.

Removing the intra-EU IP tariffs might create market distortions which need to be addressed (e.g. hoarding). Furthermore, in such a model, supply scenarios and flow patterns are more difficult to perform, creating a challenge to efficiently maximize capacity for infrastructure operators. Similarly, a reserve price close to zero, as mentioned by some consultants, will inevitably have the same implications as market zone mergers.

Topic 2: Cross-border tariffs

Some papers are challenging choices that have already been made at EU level. For instance, an optimum pricing of capacity is a Ramsey-Boiteux pricing (CEPA). However, such methodology leads to cross-subsidization from "inelastic" end- users or shippers to elastic shippers. Another example is the tarification of Interconnection Points at short term marginal cost near zero whereas the just adopted network code on tariffs prefers cost-reflectivity in those tariffs.

GIE believes that there needs to be an understanding of what the role of transmission tariffs is, i.e. that it reflects efficient use of the network, allowing recovering network costs while ensuring that markets integrate. Altering this balance significantly will likely create major contractual uncertainty, possibly triggering an undesired disruption of the European gas market and diversify. In this context a new network code on tariffs is due to be introduced. Its effects should be closely observed.

Topic 3: TSOs revenues and Inter-TSO compensation

Some tender documents suggest addressing the TSO revenue model. In this context, it is also proposed to have a common EU remuneration system/model for all TSOs. GIE underlines the high regulatory complexity associated to this proposal which would need full harmonization of all national regulation relating to the gas markets.

Furthermore, investment process under an EU inter-TSO compensation mechanism could have associated risks. How to ensure that unnecessary investments/stranded assets in one Member State are not paid by other EU TSOs? This could negatively impact the social welfare of EU consumers.

Topic 4: Security of supply

GIE agrees with the large number of discussion papers that security of supply needs to be considered within the scope of the study, especially in those countries where illiquid markets and dominant suppliers are a justified concern.

The ideal gas market design should allow finding the optimum level of investments which are needed to ensure a pre-defined level of security of supply, bearing social costs in mind. Gas and associated infrastructure play also a crucial role in safeguarding the overall energy system, which becomes more prevalent in the future with demand for system-flexibility. Associated infrastructure includes underground storage facilities and LNG terminals which provide a particularly responsive high-flexibility service in security of gas supply emergencies. Regional approaches for flexible pipeline, LNG and storage infrastructure may allow in this context for a particularly effective use of these strategically valuable assets.

Topic 5: Full harmonisation of LNG (and storage) procedures to favour better third-party access.

GIE does not see specific regulatory barriers for LNG terminals which prevent LNG coming to the European market. Therefore, GIE supports the conclusions of the CEER status review monitoring access to EU LNG terminals 2009-2013, which concluded that the current regulatory framework in the EU guarantees fair and transparent access to LNG infrastructure. The existing regulatory

framework guarantees a competitive market in Europe should therefore be upheld, as an important pillar to guarantee the attractiveness of the European market in the future.

Transparency as enabler of better access to LNG terminals and storages

To increase the transparency, GIE currently offers tools with technical and commercial information in order to promote access to European LNG terminals. Apart from the well-known GLE LNG map and GSE Storage Map, GIE has developed, on a voluntarily basis and in agreement with regulators, harmonized transparency tools (called "LNG and Storage Transparency Templates"). This one-stop-shop tool acts as a common gate allowing new users to benefit from easy access to important information on terminals and storage facilities, including capacities, tariffs or legal information relevant for terminals.

Moreover, a new LNG Services Inventory was launched in 2014 and provides an overview of the characteristics of new LNG services offered by GIE members to meet market needs. In addition, it has a special focus on small-scale LNG. GIE developed the LNG and Storage Transparency Platforms ALSI+ and AGSI+, where daily send-out flows, injections flows, storage volumes, as well as the daily amount of LNG stored at the LNG terminals within each country are published.

New products

LNG and storage operators in the EU compete with each other with NRAs monitoring these markets closely. . However, market fundamentals have changed profoundly and LNG and storage operators do not face barriers to provide optimum access (e.g. lack of innovation in the products offered, services adapt sufficiently rapidly to market changes, efficient secondary trading, satisfactory level of transparency, effective CMP, etc.).

LNG and storage operators are innovative, responding to market needs, and offering new services. In order to keep LNG terminals and storage facilities as attractive as possible, optimize their utilization and foster investments, LNG and storage operators should be able to quickly develop new services in line with market needs.

In regards to LNG, GIE welcomes the CEER assessment and believes there is no need to promote further harmonization of access regimes to LNG terminals across Europe, since LNG plays different roles in different countries and LNG business specificities should be taken into account in any future EU regulatory evolution.

About GIE

Gas Infrastructure Europe (GIE) is an association representing the interests of European natural gas infrastructure operators active in natural gas transmission, storage and LNG regasification. GIE is a trusted partner of European institutions, regulatory bodies and industry stakeholders. It is based in Brussels, the heart of European policymaking. GIE currently represents 69 member companies from 25 countries.

One of the objectives of GIE is to voice the views of its members vis-à-vis the European Commission, the regulators and other stakeholders. Its mission is to actively contribute to the construction of a single, sustainable and competitive gas market in Europe underpinned by a stable and predictable regulatory framework as well as by a sound investment climate.