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Europe's changing regulatory landscape for gas

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The Gas Target Model (GTM)
&
the Third Energy Package (TEP)

The Third Energy Package (TEP)

- **EU political objective:**
  - **single liberalised EU gas market by 2014**
- **Unbundling of transmission networks (OU, ISO, ITO)**
- **Entry-Exit transportation tariffs**
- **Regulated third party access**
- **Development of legally binding pan-European network codes (NCs) for cross-border issues**
  - ***4 NCs in place by 2014: CAM (currently being amended), Balancing, Tariffs (under development), Interoperability, Congestion Management Procedures (Reg)***
  - ***8 other NCs might follow later***

The TEP will change the architecture of the EU gas market: implementation is likely to take the rest of the 2010s but the trend is unstoppable!

GTM 1.0: the initial vision

- Establishing functioning wholesale markets
  - Division of the EU in several EE zones, each with its own VTP
  - Churn ratio > 8, gas from >= 3 sources, demand >= 20 bcm
  - i.e. an EE zone could include more than one EU Member State (or part thereof) with national market areas, trading regions, and cross-border market areas to be formed
- Connecting the markets
  - Allocation of all existing capacity via capacity auctioning
- Ensuring secure supply and economic investment
  - Integrated Auctions and Open Seasons are suggested mechanisms for allocating incremental /new capacity

Consistency of the GTM with the TEP and NCs : crucial but questionable

GTM 2.0: revised vision

- European regulators' suggestion to follow on the GTM 1.0 logic to enlarge the existing national markets as far as required so that every European end-user would be located inside a functioning (liquid spot and forward) market (i.e. meeting the expanded GTM 1.0 criteria):
  - <u>further integration</u> of existing national markets can be expected (market merger, trading region, satellite market)
- But <u>cost</u> might be a problem as this approach would require significant infrastructure investment whereas <u>market signals might not be sufficient</u>

Network Codes: connecting the markets (existing capacity) & ensuring secure supply and economic investment (incremental capacity)

The Network Codes: CAM, Balancing, Interoperability, Tariffs

- **Capacity Allocation Mechanisms NC:** auctions are the only mechanism for allocating existing capacity; mandatory bundling of Exit-Entry capacity (including new capacity) but without 'sunset clause'
- **Balancing NC:** harmonisation of balancing regimes to facilitate cross-border trading; shippers taking a greater role in balancing via trading at hubs
- **Interoperability NC:** mandatory interconnection agreements; dispute resolution rules
- **Tariffs NC:** equal treatment of transmission and transit; floating tariffs (might discourage long-term bookings)

Regulatory framework for existing capacity

Creation and usage of new capacity

- **Exemption (3rd Gas Directive, Art. 36):** TPA, tariffs, unbundling
- **CAM NC Amendment ('Incremental Proposal'):** Integrated Auctions & Open Seasons (??)
- **TEN-E Regulation:** Projects of Common Interest (general criteria of fitting priority corridors and areas, specific criteria of contributing to (at least one) market integration, SoS, competition, sustainability criteria
- **Security of Supply Regulation:** infrastructure standard N-1, reverse flows on all (intra-EU) IPs, minimum supply standards
- **Intergovernmental Agreements:** TEP (in)compatibility issues

Regulatory framework for new capacity: in the making

The GTM, the TEP, the NCs and the Third Parties

GTM and Third Parties

- 3rd Package/GTM will have a significant impact on contractual relationships between EU Member States' gas buyers and non-EU/EEA third party suppliers
- Non-EU/EEA actors inability to be part of either ENTSOG or ACER, and hence limited impact on FGs and NCs
- Lack of mechanism at the EU or regional/national level which would allow to reconcile third parties' concerns

Very limited fora where third parties concerns about the TEP and the GTM could be addressed and reconciled

The 3rd Package and the GTM: the biggest impact is potentially on Gazprom

Yafimava 2013

Number of borders crossed to reach a delivery point	Volumes, bcm/y
1	26
2	30
3	43
4	9

Gazprom's huge volumes need to cross multiple borders/jurisdictions before they reach delivery points - not comparable to any other supplier!

Russian/Gazprom concerns with the TEP/GTM

- Possibility of 'contractual mismatch' between the existing Supply and Capacity Contracts (~10 year gap)
- Potential loss of capacity under existing Capacity Contracts as a result of implementation of EE regime, with resulting capacity holdings potentially lower (and potentially more expensive due to the Tariffs NC impact as of 2017), and hence insufficient for delivery under existing Supply Contracts
- Challenge of booking additional transportation capacity across a number of EU (and non-EU) borders for delivery under existing & new supply contracts:
- Questionable ability to develop & fully utilize new multi-border long-distance pipeline capacity

Subjects of discussion/negotiation with the EU

How the Regulation has changed the structure of the European gas industry and the roles of European gas players

How Regulation Changed the Structure of the European Gas Industry in the 2000s

The dominant merchant transmission companies of the monopoly era: Ruhrgas, GdF, SNAM, Enagas, British Gas, Distrigas have all disappeared or changed ownership

Mergers and acquisitions means that the big pan-European players are: E.ON, RWE, GdFSuez, ENI, ENEL, Iberdrola, Union Fenosa, Vattenfall

Most of these new companies are dominated by their power generation and sales departments; gas is a relatively small business (and getting smaller); their managements have a trading (not a long term contract) culture and little experience of dealing with non-EU countries; they became mid-stream energy traders

How Regulation Changed the Roles of European gas players

PRODUCERS AND EXPORTERS: remained (largely) the same; able to sell directly to large customers

NETWORK COMPANIES: – TSOs and DSOs: "new kids on the block" unbundled from MTCs and LDCs, low risk/regulated rate of return

LOCAL DISTRIBUTION COMPANIES: largely the same (without their networks) not (yet) subject to serious competition for their captive customers

MID-STREAM GAS COMPANIES: became the gas departments of energy utilities; retained their long term supply and transmission contracts – with much financial risk and subject to continual renegotiation/arbitration; customer base under attack from upstream (producers) and downstream LDCs seeking to "cut out the middleman"

Contractual Space: need for managed transition

- Long Term Supply Contracts (LTSCs)
  - Some sellers have adjusted, some have refused to adjust, some are in the process of adjusting
- Long Term Transportation Contracts (LTTCs)
  - New contracts will have to be in line with the TEP
  - Lack of certainty in respect of legacy contracts

If LTSCs/LTTCs terminate, no other framework in place, until/if new contracts are concluded

Thank You!

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