

# **1<sup>st</sup> EUROPEAN GAS REGULATORY FORUM MADRID, SEPTEMBER 30<sup>th</sup> AND OCTOBER 1<sup>st</sup>, 1999**

## **Introduction and Background**

The first European Gas Regulatory Forum, organised jointly by the European Commission and by the Finnish Presidency, took place the 30<sup>th</sup> September and 1<sup>st</sup> October 1999 in Madrid. The Forum was chaired by Prof. Gaspar Ariño, Chairman of the Fundación de Estudios de Regulación.

The objective of the Forum is to provide an informal EU level framework for the discussion of issues and the exchange of experience concerning the establishment of a competitive internal market for natural gas.

This is an accompanying measure to Directive 98/30/EC, establishing a gradual opening of the natural gas market in the EU to competition. In order for an internal market for natural gas to develop effectively, a number of issues need to be addressed, such as the definition of the conditions and the tariffs for access to the network and the requirements for ensuring the efficient interoperability of the gas systems. The fundamental objective of the Forum is to develop consensus amongst all the parties involved in this process; governments, regulators and industry, in order to make rapid progress on these highly technical issues. This mechanism acts as a complement to harmonisation measures that may be necessary to achieve the basic goal of an effectively functioning single market. It also provides a forum for benchmarking between the Commission, national regulators and Member States, on a number of regulatory issues that are becoming increasing commonplace and important through the Community.

In addition to officials from the European Commission, national regulatory authorities and EU Energy Ministries, the Forum was attended by representatives from international organisations, such as the International Energy Agency, and associations representing the gas industry and gas and electricity consumers.

## **Session I: Organisation of access**

This session focused on the importance of defining a proper regulatory framework in order to introduce the conditions for an effective competition in the gas market. Mr Helm, from the consultant firm OXERA, and Mr Iñigo del Guado, from the Fundación de Estudios de Regulación, introduced the main issues and showed the risks that an inadequate level of regulation may create.

As indicated by one speaker, regulation may be considered as composed of two main concepts, correlated between each other. The first concerns the definition of all the technical and commercial conditions applying to the access to the system, with particular attention to the aspect of access tariffication ("conduct regulation"). The second ("structural regulation") concerns the decision regarding the structure of the

gas industry, in particular the obligations imposed to gas companies with regard to the limits to vertical integration (unbundling).

The importance of a high level of structural regulation may be important to guarantee that incumbents have enough incentives to promote competition. Some participants noted that the requirements of the Directive in terms of unbundling cannot ensure the application of non-discriminatory and objective conditions for system access. Vertically integrated companies may manage the different activities in terms of the general interest of the whole company, creating room for potential conflict of interests. The example of liberalisation in UK has shown that the establishment of the legal framework for liberalisation has not permitted to open the market until British Gas was separated in different companies, each pursuing its business activities according to its own strategy.

With regard to conduct regulation, there was agreement on the necessity to have at least publication of indicative tariffs, in order to give the consumers transparent and clear indications of the costs they would pay for the access to the network. Even the industry and Member States most in favour of negotiated TPA consider that prices must be published, but some room for negotiation should remain in order to take account the different situations and needs of gas consumers.

Some participants noted that negotiated TPA risks to open the room for several conflicts and dispute settlement authorities should face a situation where they would be obliged to take rapid and well founded decisions requiring a deep inside knowledge of the sector. Moreover, the difficulty that competition authorities have to prove an eventual abuse of dominant position could jeopardise the effective functioning of this system.

## **Session II: Access to the system: conditions and pricing principles**

The objective of this session was to identify the different methodologies and approaches concerning access conditions, in particular tarification, that are developing in the Member States.

At present, only a limited number of Member States have already adopted a framework governing the conditions for third party access to the gas system. Mr Callum McCarthy (Ofgem), Mr.Lopez Silanes (Gas Natural) and Mr. Verberg (Gasunie) outlined the approach to access conditions and tarification in their respective countries.

The objective of the tarification system is to move from a situation where consumers pay an all-in price for gas supply to a situation where the customer negotiates its gas supply and then get access to the system on the basis of tariffs for different services (transportation, flexibility and storage, other services).

Regarding the tarification of transportation two different methodologies are applied in the Member States:

- Entry-exit approach. This methodology is applied in United Kingdom and the most important part of total charge is represented by the fees for input into the system, offtake from the system and throughput.
- Distance related approach. It is the system applied in Spain by Gas Natural.

An hybrid system is the choice of the Netherlands, where there are fixed entry charges with distance-related charges for high pressure and a 200 Km price-cap. Mr.Verberg of Gasunie pointed out that the transmission prices in the Netherlands have been lower than in the United Kingdom during the last 5 years, despite the fact that UK was already liberalised, unlike the Netherlands. However, it must also be underlined that the Dutch system includes some particular constraints, like the strict hourly balancing regime.

However, the discussion did not focus much on the specific advantages of each system, as the experience appears for the moment to be too limited to draw some clear lessons.

It is important to underline that several speakers underlined the need to analyse in depth the tariffs system to be applied to cross-border exchange, that are at present regulated on a co-operative basis between the gas transportation companies. It is evident that this topic will be one of the major arguments of discussion for the next Forum, and the Commission informed that a study is under way to analyse transmission pricing, both from a national and from a cross-border perspective.

### **Session III: Storage**

Access to storage facilities is one of the most difficult topics of the Directive. On the one side storage is considered by the Directive as an ancillary service, therefore part of the system to which the customers is ensured to receive access, on the other side the Declaration of the Commission and of the Council annexed to the Directive established clearly that access to storage must not be independent of system use and that "should only be possible when such access is technically necessary for providing efficient access to transmission and/or distribution networks".

During this session, Mr.Higgins (BG storage) explained how the availability and the utilisation of storage facilities by gas consumers has considerably increased after the liberalisation and in particular after the moving from a monthly balancing regime to a daily balancing regime, this latter imposing a stricter "discipline" to the customer. The need for a gas consumer to have access to storage facilities increases with the augmentation of the distance from the gas trading centre. This also demonstrates the importance of having storage facilities close to the consumption point.

However, the utilisation of storage does respond to different specific needs: summer/winter arbitrage; achieving daily balance; matching peak demand; providing strategic resource for security of supply reasons. Some participants stated that, given the primary need to ensure some common objectives (like summer/winter balancing and security of supply), the availability of storage for final customer's use is very limited, if any. Mr. Paini, (Edison Gas), explained clearly that, for new entrants in the

market, availability of storage services is indispensable, given that construction of new storage facilities is not only extremely expensive, but also very difficult as potential storage areas are very scarce.

As the issue seems not to be only a matter of legal interpretation of the provisions of the Directive on access to the system, but also a question of technical and commercial availability of storage in the market, the Commission should pursue its analysis on this topic, and if possible undertake a study on the storage sector in order to identify if specific proposals are needed, also within the framework of the next year's harmonisation report.

#### **Session IV: Harmonisation and security of supply**

The Commission explained the present situation regarding the report on harmonisation to be presented according to the provisions of the Directive.

It was recalled that the study on interoperability of gas networks prepared by PLE was transmitted for comments to the industry. The Commission has already received some comments and will ensure an adequate follow-up. In the conclusion of this study, which fall under the total responsibility of the consultant, some issues are identified where the Commission will concentrate its attention in order to verify if, in particular in the perspective of the opening of the market and of the creation of an internal gas market, they may represent a potential obstacle to cross-border trade.

The industry seems to consider that a large part of the issues identified in the study should not represent a problem for cross-border trade. The gas companies have always dealt with these problems and should be able to guarantee that co-operation will continue in the future. Other participants pointed out that, in a totally liberalised framework and with the increasing of gas trade between Member States, it is fundamental to ensure that there are no potential obstacles to trade, in particular those coming from different technical regulations (gas qualities, construction design of pipelines, balancing regimes...). It has been convened that the Commission will ensure an adequate follow-up of this issue and the next Forum will discuss more in depth this issue.

#### **Conclusions**

The meeting concluded with unanimous satisfaction on the organisation of the Forum and on the quality of the discussions. The debates have been extremely useful and have permitted to establish some guidelines for follow-up.

Areas that merit further attention include:

- Regulation of the provisions governing the access of third parties to the gas system, in order to ensure that customers receive access under objective, non-discriminatory and transparent conditions.

- Definition of tariffs for the use of gas facilities, including transport, distribution and other ancillary services.
- Rules governing the exchange of natural gas between Member States, in particular the use of interconnectors and the tarification of cross-border trade.
- Conditions for the use of storage and modulation services by gas consumers and other operators.
- Analysis of potential obstacles to cross-border trade resulting from different characteristics of natural gas sectors in the Member States.

The participants agree on the need to continue this "Madrid process", which constitutes a good platform for discussion. Even if no specific date has been fixed for the next meeting of the Forum, it was convened that it will take place early 2000.