



## **EFET Principles for European Gas Market Development**

### **Introduction**

The European Federation of Energy Traders, EFET, actively contributes to the development of open, transparent and liquid wholesale gas markets throughout Europe.

Traded gas markets are an essential aspect of effective competition in gas supply. They facilitate price transparency, risk management, and market entry and exit. Supply competition provides customer choice, product innovation and variety, and improved efficiency. Accurate price signals also promote efficient investment in supply and transportation capacity, storage, and location of large consumer loads.

Established gas trading activity indicates that a market is open and transparent. Traders are continually incentivised to discover new ways of improving efficiency. The absence of traders is a strong sign that the market is not working effectively and that the efficiency benefits of liberalisation might not materialise for gas consumers.

Wholesale gas trading tends to take place in gas grids or at the connections of high-pressure gas pipelines. Access to this infrastructure is crucial for the development of traded markets. The operators of these pipelines and connected facilities therefore have very important roles. The abbreviation 'TSO' occurs many times in this document and refers to Transmission System Operator as defined in the Gas Market Directive 2003/55/EC.

This document summarises the EFET position on a number of key issues for the successful completion of the internal gas market. Where a more detailed EFET position paper or presentation material is available, this is indicated by [www.efet.org](http://www.efet.org).

This document is an expanded version of the principles for gas market development issued by EFET in October 2002.

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## **Ancillary Services**

This refers to all services that are necessary for access to a system. For networks this includes load balancing, blending, quality conversion, and allocation and metering services. Competition will be inhibited if any or all of these services are not available to all on equal terms. Where there is no competition in supply of these services, non-discrimination can only be ensured through regulated access.

## **Balancing**

After wholesale trading has been established, a cash-settled balancing market can be developed to provide market-based commercial incentives for network users to balance their inputs and outputs.

There must be no requirement on network users to balance their inputs and outputs over a shorter period than is possible by the tools and information available (e.g. network users should not be unduly penalised for an imbalance, if a TSO is unable to provide allocation information in time for them to take remedial action).

Residual system balancing is the responsibility of the TSO, whose costs that are efficiently incurred in restoring balance to the system should be allowable under a regulated revenue scheme.

## **Blending and Quality Conversion (QC)**

The first step is for TSOs to ensure transparency of actual and available QC capacities (taking into account all the means available, including blending and substitution). TSOs should then implement anti-hoarding mechanisms (e.g. Use It Or Lose It (UIOLI)) and facilitate secondary quality conversion capacity trading.

In general, access to QC schemes should be market based, non-discriminatory, flexible, provide certainty of delivery, price transparency, simplicity and not be a barrier to market entry. Where appropriate, interruptible and "backhaul" (i.e. low cal to high cal conversion) services should also be made available.

## **Capacity Trading [www.efet.org](http://www.efet.org), Presentation 28<sup>th</sup> April 2004**

Secondary tradability of capacity rights allows re-utilisation of capacity, avoids false signals created by capacity overbooking, facilitates customer switching and supply optimisation, and promotes efficient congestion management. Standardised transportation agreements should allow capacity rights to be freely traded between registered network users. Terms that facilitate capacity trading and timely procedures should be developed on a cooperative basis between TSOs and network users.

## **Congestion management**

The first step is for TSOs to ensure transparency of actual and available capacities, implementation of anti-hoarding mechanisms (e.g. Use It Or Lose It (UIOLI)) and facilitate secondary capacity trading.

In general, congestion management schemes should be market based non-discriminatory, flexible, provide certainty of delivery, price transparency, simplicity and not be a barrier to market entry. The sale of interruptible capacity and application of capacity release and use-it-or-lose-it mechanisms should ensure that congestion management is only necessary when infrastructure is physically congested, and not when it is fully booked but only partly utilised.

Allocation of capacity should be based on commercial principles, such as auctions, taking care that the method of implementation avoids giving an unfair advantage or priority to an incumbent. Operational congestion management techniques, resulting from the over-allocation of capacity or operational problems, are best dealt with by the TSO or other infrastructure operator buying back capacity, or by other market-based and or equitable approaches.

## **Credit Guarantees & Clearing**

Requirements for credit guarantees (e.g. by TSOs) must be necessary and proportionate, to avoid these becoming an undue barrier to trade. Clearing between market participants offers a facility that reduces the counterparty risk and is a useful feature of traded markets. The costs of clearing are in essence an insurance premium, and it should be a commercial decision for trading companies as to whether or not they use clearing facilities.

## **Entry/Exit Implementation**

[www.efet.org](http://www.efet.org), 25<sup>th</sup> September 2003 and presentation 28 June 2004

Well-designed entry/exit systems help the development of competitive energy markets. Capacity can be used more efficiently, if entry is separated from exit capacity. A party seeking to acquire or dispose of capacity does not need to find a counterparty with exactly the same pair of source and customer points, allowing capacity to be reallocated effectively. Gas Customers can more easily switch to a supplier who is able to bring gas more cheaply through a different entry point than the former supplier. By mirroring the overall operation of the network, price signals can be made more reflective of the costs incurred when the operator optimises the physical system. The creation of a virtual trading point between entry and exit can promote trading and imbalance management.

Implementation should follow a number of key principles:

- Entry capacity and exit capacity must be separately bookable.
- Entry and exit tariffs for a system must first be calculated by analysing the physical flows in the whole of that system.
- There must be just one or a small number of balancing zones.

To ensure that entry/exit systems improve access conditions for new entrants there must first be effective unbundling of the TSO(s). Regulators will need to ensure that TSOs are properly incentivised to maximise the capacity made available to the market at system entry points

### **Harmonisation of Gas Quality**

Europe may need different Gas Quality specifications in different pipeline systems, but lack of harmonisation in this area should not be used as an artificial barrier to trade. Once gas has entered one EU pipeline system (in line with its specification), the TSO must accept full responsibility for delivering a satisfactory gas quality at any exit from its system.

Transparency over the kind of gas quality that is acceptable in a system will help avoid concerns that a TSO might reject gas from one counterparty on the grounds of quality, while at the same time accepting gas of the same quality from another party.

### **Harmonisation of Rules and Regulation**

Harmonisation of rules across Europe will help promote interconnectivity and interoperability and the functioning of the European gas market as a whole, rather than as a series of connected national markets. Divergent legal standards, particularly in gas transmission access, increase transaction costs and cause distortions in competition. A certain degree of harmonisation is therefore required to ensure a level playing field in the internal gas market in Europe. Significant differences in the access rules and processes for connected Transmission Systems cause barriers to cross border trade and have led to the need for a Gas Transmission Regulation.

### **Harmonisation of Units**

Whilst several different units might be used for physical measurement, the units used for all communications with traders or suppliers must be standard units. For example, gas is traded in energy terms and balancing operates in energy terms. In line with the recommendations of the Madrid Gas Forum, all TSOs should publish their pipeline capacity and aggregate flow information also in energy units/time.

### **Information and transparency, [www.efet.org](http://www.efet.org) 6<sup>th</sup> May 2004**

Inadequate information availability causes lack of confidence and potential market distortions that can become serious barriers to entry or prevent trading. All infrastructure users, or potential users, must have the same level and timing of information provided by the operators, for example on the internet. Network and storage operators must provide all users with the information they need for efficient access to the system. Published information must include actual and available aggregate capacities, historic aggregate flow rates, maintenance schedules etc.

### **Investment in infrastructure [www.efet.org](http://www.efet.org), 29<sup>th</sup> May 2002**

Network operators should be sufficiently unbundled to ensure that there is no conflict of interest when making investment decisions.

It is important that the market is allowed to send accurate signals to the TSOs, and that they are then able to respond to these signals to provide an efficient level of network capacity. Investment is necessary to enhance the interconnectivity of Europe's pipeline grids. Where such investments link two local transmission systems then the development should be the responsibility of the (regulated) TSOs. (*See also Transit for investment in major interconnectors*)

## **LNG**

Gas quality compatibility is a key issue: LNG should be fungible with piped gas. The key to market opening is to ensure that there is market access to terminal capacity, so that use of capacity is maximised. Non-discrimination by the LNG facilities operator is essential. In some circumstances, a market approach, in which there are unbundled tradeable services (berthing, storage, sendout) will help to optimise LNG terminal usage.

## **Market opening and consumer choice**

Until the market is fully opened there will always be potential problems of cross-subsidisation. A fully opened gas market will also improve liquidity due to suppliers having to adjust their positions as customers switch from incumbents. New entrants will also need to manage their positions.

There should be no undue delay between the full opening of the industrial and commercial gas market, that should have been implemented no later than 1<sup>st</sup> July 2004, and the subsequent opening of the market to all residential consumers by 1<sup>st</sup> July 2007. Legal opening of the market is, however, insufficient by itself to allow retail supply competition to develop.

**Network Access** [www.efet.org](http://www.efet.org) 25<sup>th</sup> September 2003

There must be properly approved and supervised non-discriminatory third-party access to gas transmission and distribution networks, under a network code or other published common terms and conditions, which should also be available in the English language. (*See also Information and Transparency*)

**Regulatory Framework**

An independent competent and well-resourced authority, with clear ex-ante powers, ex-post sanctions and responsibilities to promote the development of competition, is a key component of successful energy market opening. The national and EU regulatory frameworks should both play an important role to ensure that the benefits of the single energy market reach all customers.

Effective network regulation needs clear transparent rules and tariff regimes defined in advance. The regulatory process must allow the rules to be changed when necessary, so that network and storage users can continue to have fair and non-discriminatory access to networks.

**Release programmes and Access to Gas** [www.efet.org](http://www.efet.org) , 23<sup>rd</sup> June 2003

Release programmes (of which there can be various types) can be designed to overcome the problem of inadequate access to supplies or capacity, particularly in the early stages of market opening. This can be particularly useful when there is aggregate oversupply in a market, no new sources are expected, and access to the existing sources determines market entry. EFET encourages such schemes where they would have an important 'catalytic' role in the context of developing sustainable competition in gas markets.

**Security of supply** [www.efet.org](http://www.efet.org) , 30<sup>th</sup> October 2002

Security of supply is achieved most efficiently within a competitive market framework. The greatest danger for the future of Europe's gas supplies is the continuing uncertainty and delay in implementing a single energy market. There must be transparency in the application of security of supply policies to avoid unnecessary distortion of the wholesale markets.

**Short-term services**

The availability of competitively priced short-term capacity is essential for the sustainable development of the competitive market. Capacity that has been contracted on a long-term basis should be subject to a UIOLI regime. Among the targets accepted by TSOs at the 7<sup>th</sup> Madrid Forum, for implementation by July 2004 were to offer firm and interruptible services with a minimum contract duration of one day and to provide reliable on-line information.

## **Storage** [www.efet.org](http://www.efet.org) , 8<sup>th</sup> June 2004

Third party access to storage is an essential feature of gas market opening. Storage providers that have, or share, dominant positions must be regulated during the transition to fully competitive conditions. The Gas Market Directive 2003/55/EC requires regulators to ensure that there is fair and non-discriminatory access, both for regulated and negotiated access regimes. Guidelines are needed for all Storage Operators to ensure sufficient information transparency and their non-discriminatory commercial behaviour. All market participants must be allowed access to storage that is required by the Gas Market Directive\* to offer TPA services on a fair and non-discriminatory basis.

Guidelines for Good Practice for the Commercial Operators of Storage Facilities are needed both in regulated and negotiated regimes, and should be applied through Storage Codes and Contracts Terms that are transparent and non-discriminatory.

### **Supply competition**

A competitive wholesale market needs both buyers and sellers. EFET supports retail competition in gas supply so far as this relates to the development of open, transparent and liquid wholesale markets. (*See also Market Opening*).

Qualification procedures for supplier and shipper licences must be simple and sufficiently harmonised to avoid these becoming an undue barrier to entry.

### **Tariffs and tariff regimes**

Tariff structures must be designed to facilitate the development of competition, especially wholesale gas trading and the development of liquid gas trading hubs. Tariffs must be non-discriminatory and cost reflective. EFET believes that entry-exit tariff regimes (combined with an entry-exit capacity systems) offer the best solution.

### **Taxation of energy**

Differences in the approach to the taxation of energy (VAT, excise duties and other gas taxes) are a serious constraint to trade. Until this lack of consistency is eliminated, all gas trading hubs should be treated as tax-free warehouses, within which there is no tax payable on trading within the hub. Any taxes payable on exit from the hub would be paid in accordance with the tax legislation in the jurisdiction concerned.

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\* The Gas Market Directive notes that storage access must be fair and non-discriminatory, and is for the supply of customers. 'Customers' are defined to include wholesale purchasers of gas (i.e. traders), not just end consumers.



### **Trading hubs [www.efet.org](http://www.efet.org) , 29<sup>th</sup> March 2003**

The establishment of liquid gas trading hubs will provide real price signals and enable resources to be used more efficiently. Without effective energy trading, there will be no substantive competition in energy supply.

The development of new gas trading hubs in Continental Europe is supported by EFET's Gas Hub Development Group. EFET urges hub operators to ensure that the services they are aiming to provide will meet the needs of their future customers and are being harmonised between the various hubs.

Well functioning and liquid hubs improve:

- Security of supply
- Competition in both the retail and wholesale markets
- Transparency in the market and pricing of gas.

### **Transit and Long Term Capacity Booking**

[www.efet.org](http://www.efet.org), 9<sup>th</sup> September 2004

Restricted access to pipeline capacity is one of the main barriers to cross-border gas trade and a significant reason for the slow development of a competitive EU gas market. The principle of transparency of aggregated information is essential if market confidence is to develop and is particularly important where there is a requirement for non-discriminatory TPA.

- Active co-operation between National Regulators, with Regulators and the European Commission exercising their authority, is needed to ensure that there is non-discriminatory TPA to all existing gas transit lines
- National Regulators and the EU Commission should ensure that all new interconnectors comply with pro-competitive requirements, including an open season for capacity booking, transparency (e.g. aggregate flows) and that the Operators facilitate Secondary Capacity Trading.

### **TSO obligations [www.efet.org](http://www.efet.org) , 9<sup>th</sup> July 2004 (TSO GGP)**

TSOs should be responsible for the operation, maintenance and economic development of their networks, including the provision of sufficient interconnection capacity. TSOs should be responsible for ensuring interoperability with connected networks and implement Interconnection Agreements (IAs) and Operational Balancing Agreements (OBAs). These agreements must ensure that gas can easily be moved between different wholesale markets, without the TSO trying to impose technical or operational constraints or potential liabilities on wholesale market participants who have met the entry requirements for gas within a European transmission system. (*See also Information and Transparency*)

**Unbundling TSOs** [www.efet.org](http://www.efet.org) 23<sup>rd</sup> June 2003

Sufficient separation of infrastructure operators from infrastructure users is recognised in the Gas Market Directive as a prerequisite of avoiding potential cross subsidies and ensuring fair and non-discriminatory access.

Unless there is full ownership unbundling, there are two key questions that should be asked of each and every organisational change:

1. Is this fair and non-discriminatory towards third parties?
2. Does this enhance the development of a competitive market?

The legally unbundled TSO must be responsible for the safe and efficient operation, maintenance and development of their network to meet all reasonable demands of current and future network users. EFET's view is that the TSO must be truly unbundled also by physical and financial separation from affiliates, including all production, supply and wholesale or retail trading. A compliance officer will be needed to oversee the operational and behavioural changes that effective unbundling requires.

**Use-it-or-lose-it (UIOLI)** [www.efet.org](http://www.efet.org) , 12<sup>th</sup> October 2002

UIOLI is an essential tool to ensure that all capacity that could be used is made available to market participants. Firm UIOLI involves the release of capacity that has not been used for a significant period of time. Interruptible UIOLI is normally applied on the day and involves lending forecast unused capacity to another user on interruptible terms. A well-designed interruptible UIOLI system encourages holders to trade unused capacity, increases capacity availability and can eliminate the need for long-term capacity release.

**What should be regulated?**

Monopoly services associated with the transmission and distribution, as well as gas storage systems for which there is no economic alternative, must be regulated with published tariffs or with an approved transparent market-based pricing mechanism.

Competitive services that are shown to be subject to sufficient competitive forces do not need regulatory intervention. Transparency of aggregate information will remain important, but the prices and commercial arrangements can and should be left to the parties involved.