

Slow Progress Expected on European Gas Trading

Ownership unbundling, greater third-party access to transmission and storage and more data transparency are regarded as important steps in creating an effective European gas market. This is the main conclusion of Moffatt Associates' latest European Energy Trends Survey.

Market scepticism

Despite continuing problems with the development of a competitive and transparent power trading market in Europe, electricity, as a tradable commodity, is still far ahead of gas. The results of our survey on this quarter's special topic of gas market liberalisation shows that there is a lot of scepticism in terms of when EU wide gas trading will finally begin to take off and start to rival trading in the power market.

Progress in liberalising the gas sector has been slow. The gas market continues to suffer from a lack of liquidity of both gas and transport capacity, while continued long-term gas contracts can cause market distortion. Despite the best efforts of the European Commission, the gas market is still essentially national, with a number of large and dominant players effectively controlling the market. There is a lack of available gas for new entrants and limited scope for moving gas around the European network because of inadequate interconnections.

The UK, where the total market share of the three wholesale gas suppliers is less than 40%, is the only member state where competition has really begun to take hold, followed by Italy, where the equivalent figure is 60%. In the other European markets, the market share of the three wholesale gas suppliers still exceeds 70%.

A determined Commission

However, the European Commission is increasingly determined to make progress in creating a single power and gas market in Europe. The decision by the Competition Directorate to act against member states over the failure to implement the electricity and gas directives, and to investigate apparent restrictions and distortions of competition, show the EU authorities' strengthened resolve to remove obstacles to a single market. The recent dawn raids by the competition authority investigators targeting a number of European gas companies suspected of an abuse of power was further evidence of the EU's determination to act in this matter.

Initially, the plan was that a single pan-European energy market would gradually emerge as national markets became more competitive and more integrated. However, it has become obvious that this is a long-term ambition and that more decisive action needs to be taken to encourage the development of a genuinely integrated energy trading market. ▶



A regional approach

Earlier this year ERGEG, the EU energy regulators' association that advises DG TREN, put forward a framework for regional developments in both power and gas. In February it proposed the creation of seven macro-regions for power which would serve as the building blocks of a single European energy market, followed in April by a similar project for gas, this time with four macro-regions. Figure 1 shows the planned projects for gas.

Figure 1. ERGEG's four regional energy market (REM) projects for gas:

Region	Countries	Lead regulator
North-West	Netherlands, Belgium, France, United Kingdom, Ireland	Netherlands
North	Germany, Denmark, Netherlands, Sweden	Germany
South	Spain, Portugal, Southern France	Spain
South-South-East	Italy, Austria, Slovakia, Hungary, Slovenia, Greece, Poland, Czech Republic	Italy, Austria (co-chairs)

Source: ERGEG

As the table above shows, the boundaries used to establish regional markets are not always clear-cut. For example, France has been included in two regions, with northern France included in the North-West region and southern France in the South region.

A detailed timetable for introducing these regional initiatives will be published over the Summer, with more information

on stakeholder participation also being gathered. ERGEG plans to compile a first overall progress report of the four REMs in late Autumn 2006, followed by a consultation at the Madrid regulatory forum, where gas regulation issues are discussed by national regulatory authorities, the European Commission and other gas market participants. After this, work to establish the regional markets will commence from 2007 onwards. ▶



The European Federation of Energy Traders (EFET) has welcomed the ERGEG regional gas hub proposal, while emphasising that initial efforts on improving liquidity and cross border trade between the existing trading points in Belgium, the Netherlands and northern France, an area where there is existing regulatory cooperation. Results from this pilot study would help to identify what actions should be taken to stimulate trading at and between these hubs, and could be extended to other regional hubs.

Many of our Panel members had clear ideas about where some of the hubs should be located. Favorites were NBP, Emden/TTF, Baumgarten, one hub based in southern Europe, perhaps on the French/Spanish border, and possibly one in Eastern Europe.

Expectations for gas trading

There was widespread scepticism amongst the Panel about whether gas trading would take off within the next two years, although greater confidence that this would begin to happen within a period of five years. Our respondents did, though, welcome the fact that the European Commission is showing renewed determination to make progress on establishing the single market, and in particular they supported the greater involvement of the EU competition authorities in monitoring and dealing with the situation.

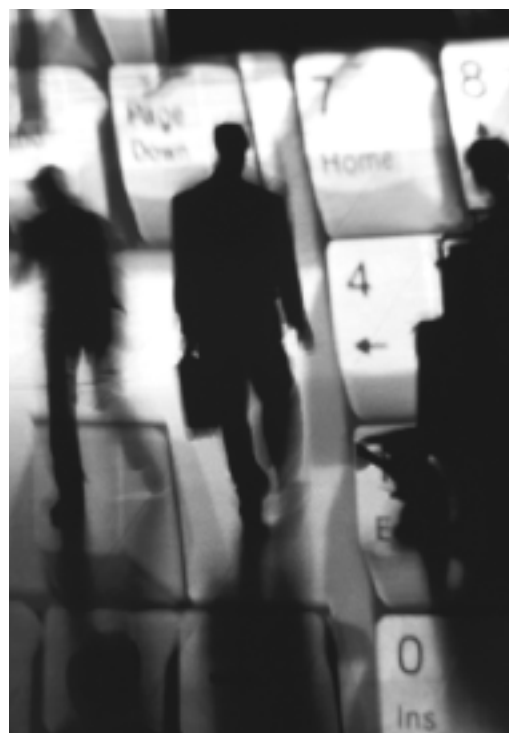
Some of our Panel, while supporting the ERGEG proposal in theory, were sceptical about how successful this would be in achieving a genuinely liquid gas trading market. Establishing regional hubs may not, in itself, create the conditions necessary to stimulate trading in the market, and more

important than regulatory actions is the need for the market to be driven by commercial concerns. Other Panel members believed that regulation is the key to establishing a proper trading market, and were pleased that the competition authorities now appear to be taking the lead in ensuring that the markets are liberalised in line with EU legislation.

Conditions for success

In drawing up its regional markets initiative, ERGEG has identified a number of issues which need to be addressed to provide sufficient opportunities for competing gas supply companies. These include incentives for investment, availability of gas, cross-border compatibility, for example in balancing and flexibility regimes, and information transparency.

In terms of what could be done to improve liquidity in the gas markets, our Panel members were divided over what measures should be prioritised, and which were ►



the most practical (See Figure 2 below). Favoured measures were forcing ownership and not just legal unbundling of transmission and distribution, forcing incumbents to provide greater transmission and storage access to third parties, and creating more transparent data on capacity, transmission and storage. In terms of how achievable each of the measures would be in practice, however, there was a degree of pessimism over what could actually be accomplished, with no measure receiving a strong vote of confidence from our Panel.

Nine countries have not implemented any unbundling, while the remaining five EU member states have been allowed to derogate from the unbundling principle.

Another problem facing the European gas market is the lack of a clear framework for network access conditions, especially for transactions between TSO areas. This should be addressed by the new regulation on access to gas networks (1775/2005), which came into force on 1 July 2006.

Figure 2 - Panel ratings of measures to improve gas market liquidity (on a scale of 1-10 where 1 not important/practical and 10 very important and very practical)

	Priority	Practicality
Force ownership not just legal unbundling of transmission and distribution	7	5
Force incumbents to provide greater transmission and storage access to third-parties	7	5
Create more transparent data on capacity, transmission and storage	7	5
Increase imports of LNG to diversify sources of supply	6	5
Make long term import contracts more flexible so incumbents have to trade more	6	5
Use more gas release programmes to help new (supplier) entrants	5	5
Use gas swaps to facilitate cross-border trading	5	5
De-coupling link to oil price so prices better reflect demand and supply of gas in Europe	5	5
Impose "use it or lose it" conditions to maximise use of UK interconnector	5	4

The lack of unbundling of gas transmission is a clear barrier to the achievement of an integrated gas market and to the emergence of a liquid and transparent gas trading market. Only Denmark, the Netherlands, Sweden and the UK have instituted ownership unbundling, while seven countries: Austria, Belgium, France, Germany (partially), Italy, Spain and Hungary, have instituted legal unbundling.

Diversification, access and transparency

As well as strengthening security of supply, gas needs to be imported from new sources into the EU if the market is to be made more competitive. One positive development which could help to encourage the emergence of a gas trading market in the EU is the growing investment in LNG, and plans for LNG terminals are well-advanced in a

number of EU member states. The European Commission believes that LNG is a key source of diversification, and in the medium-term this should help to establish a trading market for gas in the EU.

The inadequacy of the data available continues to represent a significant barrier to trading in the gas market. A lack of adequate information on prices will continue to prevent the development of a liquid and transparent market, and this obstacle will need to be addressed if trading is to develop. Most of our Panel members thought that exchanges could play a role in encouraging and facilitating more liquid markets for gas in Europe, particularly by releasing daily supply and demand data in the various countries, and by providing a transparent price reference. Gas is already traded on the APX exchange, while the EEX hopes to introduce a gas trading contract from autumn 2006. Other exchanges are likely to follow suit.

Other initiatives which should help to stimulate trading in the gas market

include the voluntary agreement reached last year by the Madrid regulatory forum on conditions for access to gas storage. The agreement sets minimum requirements for fair and non-discriminatory access to gas storage facilities and services in line with the EU Gas Directive. However, the results of the agreement have so far been uneven, with ERGEG reporting at the last meeting of the Madrid forum in May this year that compliance on transparency and on third part access services remains insufficient.

In conclusion, gas lags behind power in terms of the development of a liquid and transparent trading market. EU initiatives should help to create the conditions for a more integrated market, but it is not yet clear how successful plans such as the ERGEG regional market initiative will be. There is a lot of scepticism amongst market participants about how quickly gas trading can develop, and a recognition that much still remains to be done, not least the need to make more gas available, if gas trading is to take off in the next few years. ■

