CEPMLP Talk:
16th November 2005

by

Margot A. Loudon

Structure

PART I European Gas Market Opening

– The liberalization process
– Current developments
– 2006 – the year of debate

PART II - European and global gas market trends

PART III - Other policy issues with an impact on the gas market
- Implications for the future

PART I – European Gas Market Opening

European Gas Market Opening

Development of a Political/Legislative Framework

1985 The EU began to develop politically and economically; the objective was to create one single market for goods, services, persons and capital

1990 First proposal on gas and electricity internal markets adopted in 1998 after years of debate (1998/30/EC)

2003 Second Gas Directive adopted (2003/55/EC) – implemented in July 2004

2003 TO PRESENT DAY More detailed regulatory developments of EU level (and at national level)

KEY ELEMENTS OF 1998 LEGISLATION (MINIMUM REQUIRED)	KEY ELEMENTS OF 2003 DIRECTIVE
Framework Directive – laying out broad rules for organization and function of market	More detailed and prescriptive
Gradual market opening – starting at 20% - target 43% eligible customers by 2008	Market open to all non-household customers by July 2004, all customers by July 2007
Accounts unbundling/ Chinese Walls	Legal unbundling
Option TPA/RTPA for networks	RTPA for networks. Option for storage access
« Mechanisms » for regulation, control and transparency	Independent Regulatory Authority

Characteristics of EU Gas Market Pre-Market Opening (1)

KEY PLAYERS

- Oil/gas producers
- Integrated national merchant companies purchased, sold, built infrastructure, and transported gas variously to large consumers, to city gate, to domestic consumers
- National Governments determining energy policy to differing degrees.

SEPARATE NATIONAL MARKETS – DIFFERENT CHARACTERISTICS

- Gas rich countries (UK, Netherlands) Import dependent (France, Belgium)
- Mature markets/Young markets
- Competition except for UK
- Integrated distribution
- Hundreds of distribution companies
- Stable or falling prices

Characteristics of EU Gas Market Pre-Market Opening (2)

SUPPLIES

- Diversified
- Underpinned by long-term contracts (Take or Pay)
- Contractual linkage of wholesale gas prices to oil

The debate was marked by resistance to change. Points included:

- energy is special; it is not like other goods (argument that energy was a “service” was rejected)
- energy is primarily a matter for national not European level policy – dependency on external imports featured in this argument
- fragmentation of the market will weaken Europe’s merchant gas companies in their relations with producers
- liberalization will have adverse impact on security of supply

Continuing regulatory developments at EU level – aimed at gas system operators (TSOs, SSOs)

- Regulation on Access to Gas Networks (tariffs methodology, capacity allocation, congestion management, interoperability)

- Guidelines on Access to Storages (option for NTPA/RTPA – cover access services capacity allocation and congestion management, transparency as well as confidentiality requirements, secondary market)

- In preparation rules/guidelines on balancing, entry/exit systems, capacity calculation

Prime motivations
- oversight of monopoly activities (relevant to most countries)
- reinforcement of non-discriminatory objective

Other continuing regulatory developments at EU level

Regulatory Road Map – in addition to looking to bring forward more rules on TSO related aspects will also look at

Hub development – balance of market/regulation?
Unbundling-efficiency of legal unbundling?

Prime motivation – to ensure a well-functioning wholesale market

Also the Regulators with reference to Annex A of 2003/55/EC are looking to bring forward good practice recommendations on customer switching and customer protection

Prime motivation – to get the retail market moving

Progress in the market is under scrutiny (1)

2005 Progress Report

- required by Article 31 of 2003/55/EC
- Benchmarking
- Political comment

Likely to conclude there has been progress but not enough

Progress in the market is under scrutiny (2)

The Sectoral Inquiry

- prompted by rising prices and complaints
- carried out in consultation with NRAs, NCAs, market players, customers
- focus on wholesale markets, access to gas, to capacity to flexibility and customers
- competition issues including market abuse, weak unbundling, lack of transparency
- Interim Report – December 2005
- Final Report 2006
- Case Investigations where appropriate

During 2006 there will be a continuous debate on the energy market, kicked off by Progress Report and Interim Report of DG Competition.

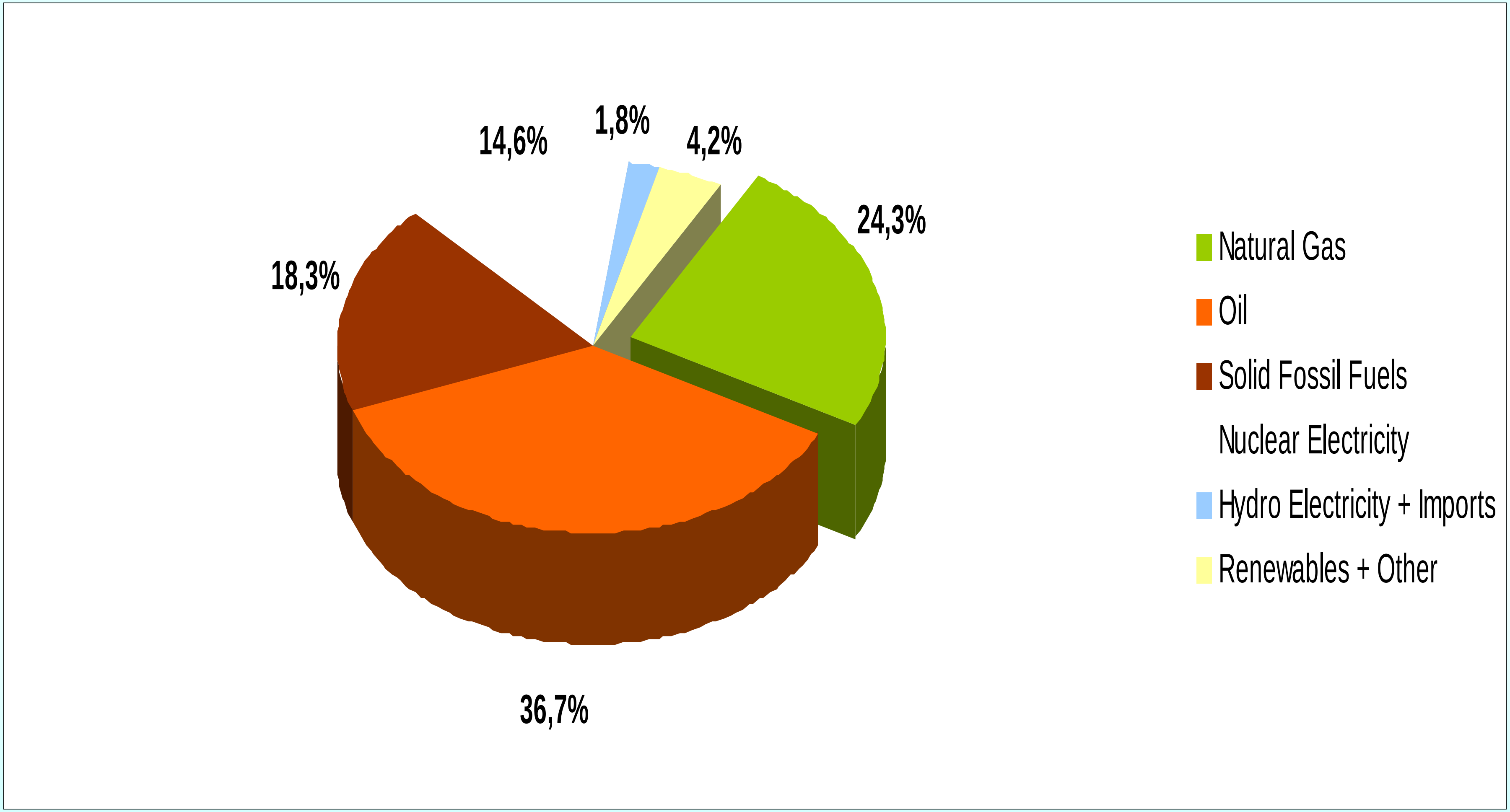
Also related topics will be discussed

- Energy Efficiency (Green Paper “Doing More with Less”)
- Security of Supply (Green Paper on a Secure, Competitive, and Sustainable Energy Policy for Europe)

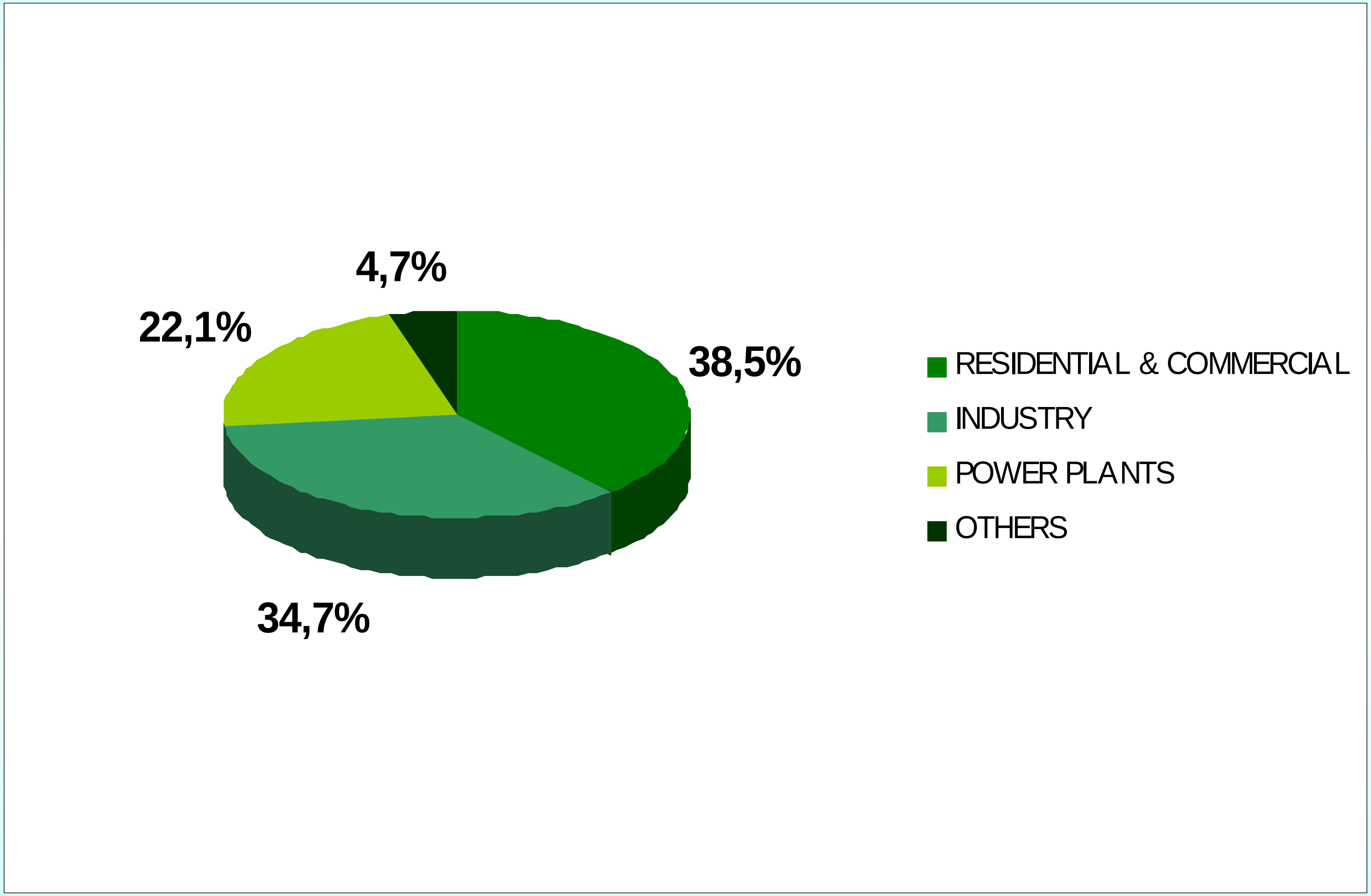
End of 2006 - Decisions

PART II: European and World Gas Market Trends

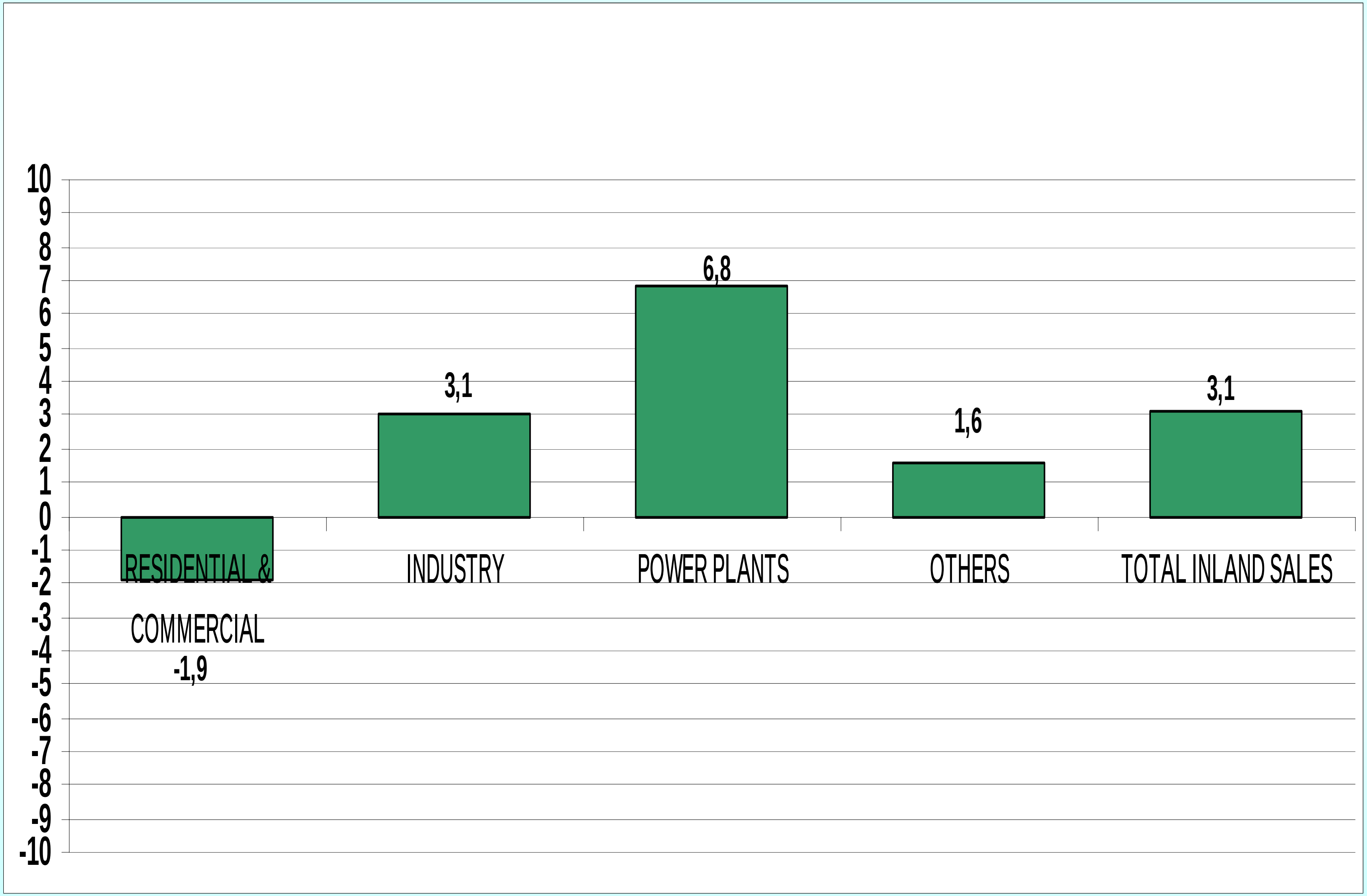
2004 Primary Energy Consumption by fuel (EU 25)



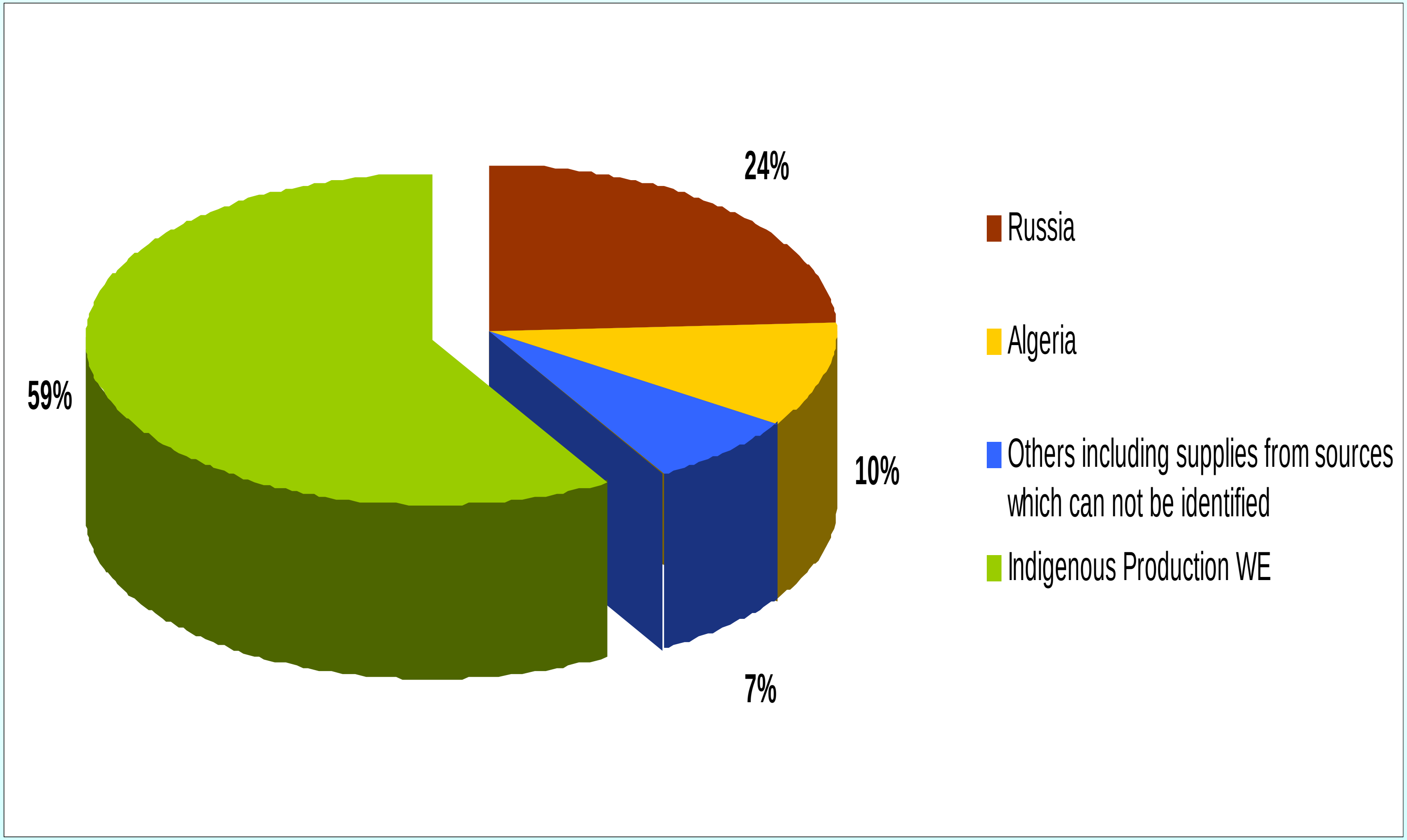
2004 Natural Gas Sales by Sector (EU 25)



2004 Gas Demand Growth Rate by Sector (EU 25) over 2003 (%)



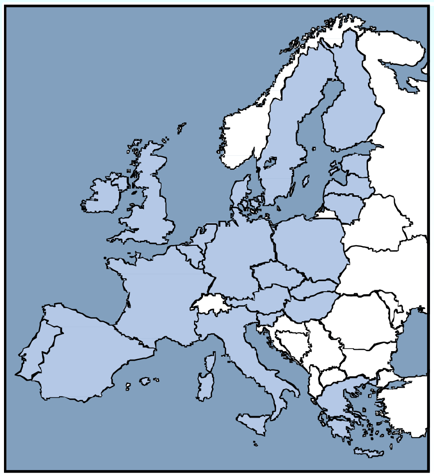
2004 Breakdown of Europe's Natural Gas Supplies

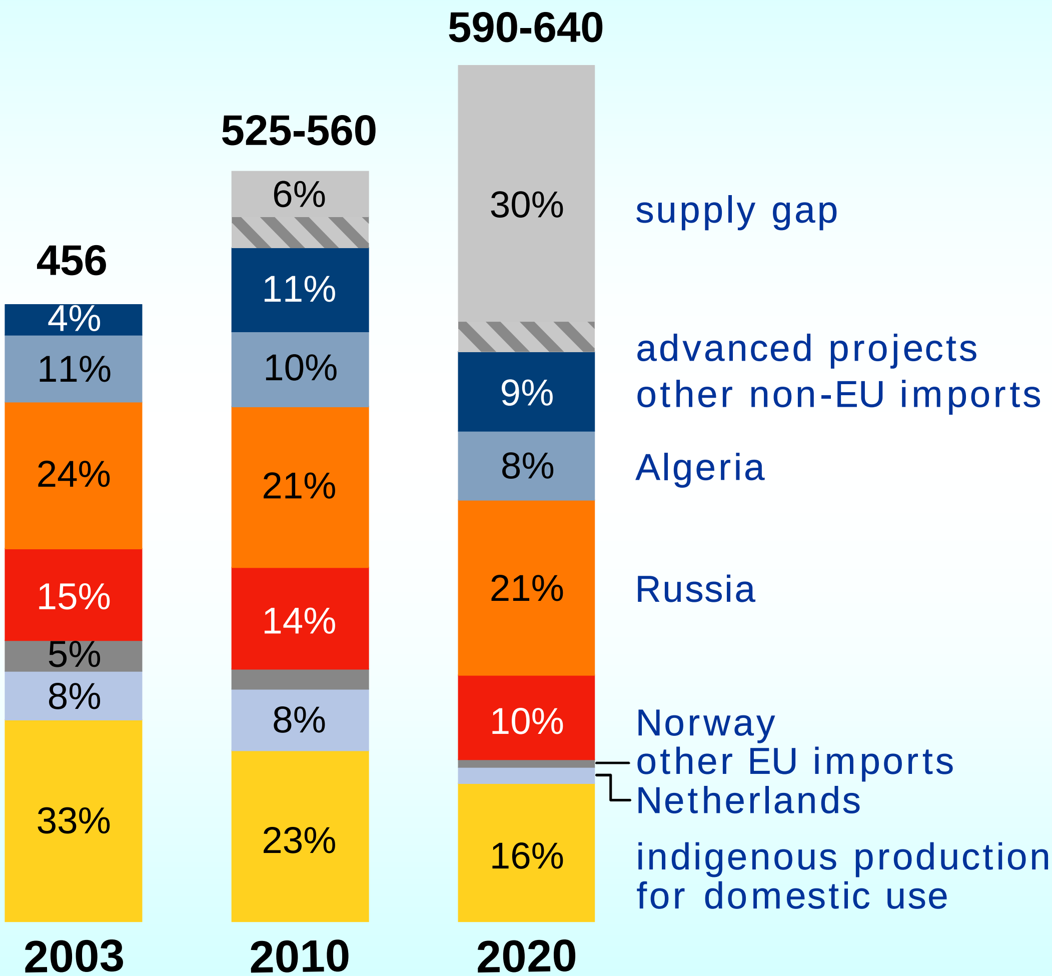


Nearly 81% by pipeline

Development of Natural Gas Supplies in the EU25

billion m^3



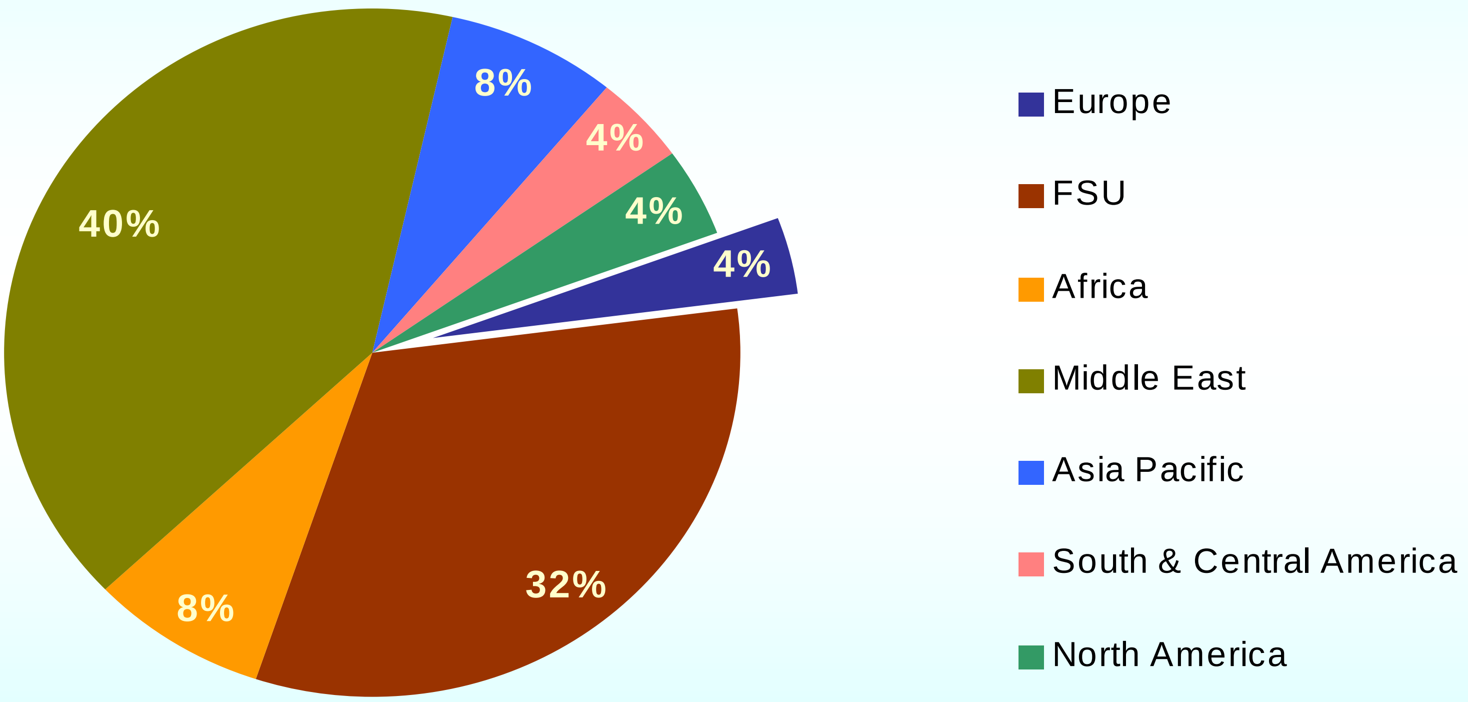


Remark:
Malta and Cyprus are not supplied with natural gas

10%	15%	17%	LNG share (in imports)

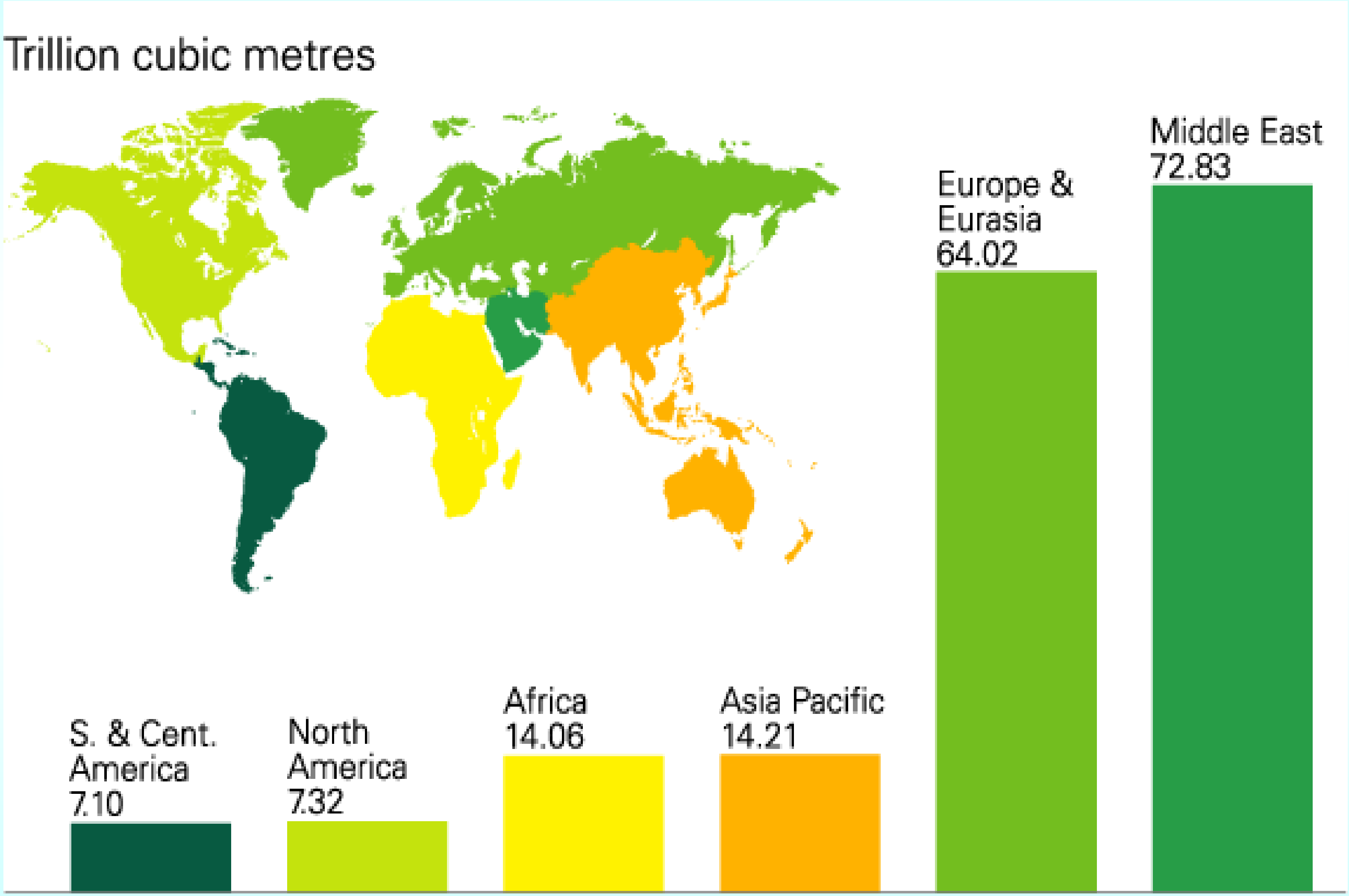
Source: E.ON Ruhrgas

World Natural Gas Reserves by Region



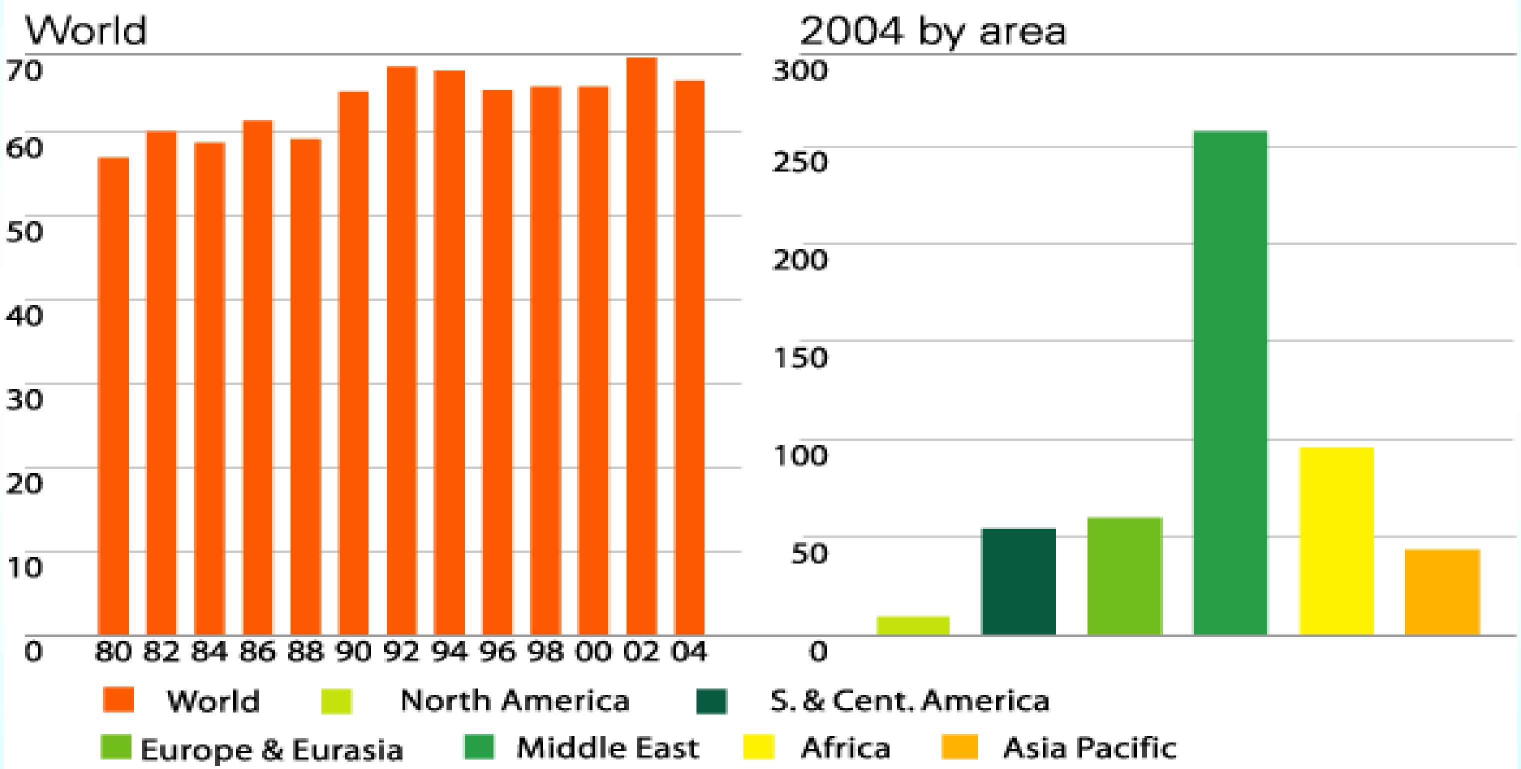
Source: BP

Proved Natural Gas Reserves at End 2004



Source: BP

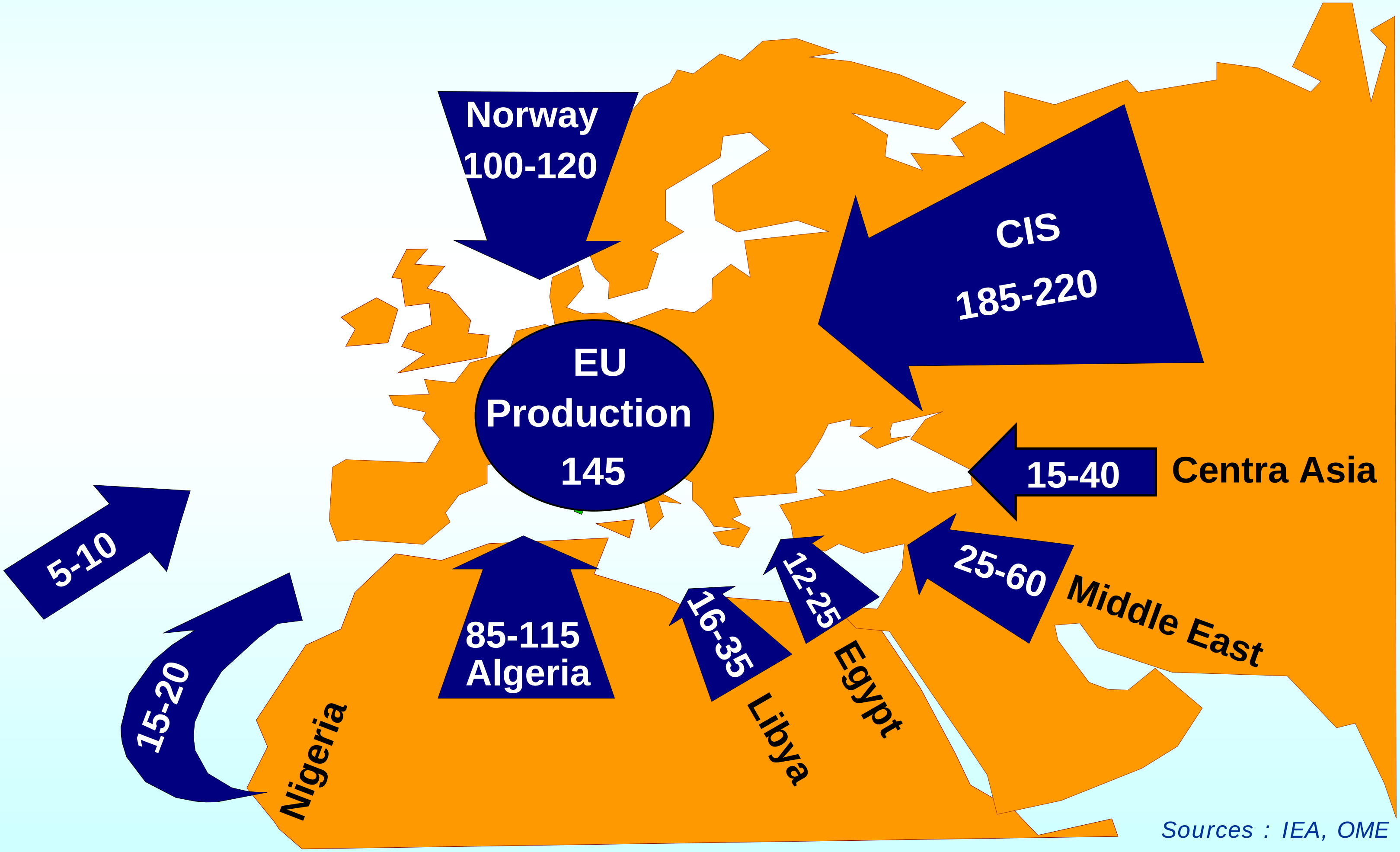
Natural Gas Reserves-To-Production (R/P) Ratios



The world's gas reserves-to-production (R/P) ratio declined to 66.7 years in 2004, but remains well above the oil R/P ratio. Gas reserves are 26% higher than the 1994 level; production is 28% higher.

Source: BP

Supply Capacities for Western Europe 2010-2020 (billion m³/year)



Sources : IEA, OME

PART III: Other Policy Issues

Increasing dependency on non-EU sources – geopolitical issues

Global competition increases (China, India, North-East Asia, US)

New supplies will seek the most attractive markets

LNG market will mushroom

e.g. - about two dozen LNG terminals are “on the drawing board” in US

- 2 LNG terminals under construction in China

- Russian policy to give tax-break on LNG exports

- new LNG terminals in UK, France, Spain and Portugal, Italy and Germany (?)

ENERGY EFFICIENCY

- Environmental and security of supply objectives
- Decouple GDP from per capita energy use
- Energy sales $\rightarrow$ energy services

ENVIRONMENT AND SUSTAINABILITY – esp. CO_2 reduction policy

- Fuel switching (gas to power is main uncertainty in demand forecasting)
- Emissions Trading
- Renewables policy incl. biomass action plan
- Clean Coal technologies, carbon sequestration, alternative energies

SECURITY OF SUPPLY

- Fast rising global demand
- International competition for supplies – geopolitics
- EU potentially a large actor
- Investments and how to realise them
- Prices/impact on competitiveness

Gas Market Today And Future Trends

KEY PLAYERS

- Oil/gas producers
- Customers
- Unbundled “merchants”, new comers, traders
- Energy giants/multi-utilities
- EU
- National Governments
- National Regulators

MARKETS

- New gas trading mechanisms
- New cross-border activities
- Grids $\rightarrow$ state/private capital introduced into supply
- Varying levels of competition
- Changes in distribution sector
- Volatile prices

SUPPLIES

- Diversified
- Long-term contracts (but with new flexibilities)
- Spot-market
- Gas oil/price linkage

Rising gas demand in the EU

- by as much as forecast? (how far will other policies bite?)
- price evolution (not just gas but also electricity?)

The market's ability to deliver security of supply

- is the market functioning efficiently?
- is there a fundamental shift in security of supply conditions?
- if there is a problem, is the solution more market, more regulation, more "planned" market?
- impact of competition policy?

The EU's role

- improving the competitive market?
- developing EU level security of supply instruments?
- promoting and co-ordinating investment?
- spreading liberalisation?