Reports of the Consultative Committees on Third Party Access to Natural Gas Networks

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COMMISSION OF THE EUROPEAN COMMUNITIES
Directorate-General for Energy

COMMISSION
OF THE EUROPEAN
COMMUNITIES

Foreword

I am pleased to present here the reports by the Consultative Committees on access by third parties to natural gas networks.

The creation by the Commission of these Committees, one made up of representatives of the Member States and the other of representatives of the gas companies and consumers, is explicitly mentioned in the Communication by the Commission to Council COM(89)334 which accompanied the draft directive on gas transit, now adopted by Council.

This consultation seemed necessary in order to explore, beyond the stage of transit, ways of making the greater European market of 1992 a reality in the natural gas sector, of strengthening competition and of widening consumer choice.

The task of the Committees was to identify the main technical, economic and administrative elements to be taken account of in the formulation of a Community policy on whether, and how, third parties should have access to gas networks.

This task of analysis and clarification has been successfully concluded. I would like to thank all Committee members for having participated actively in discussion, for sharing their expertise and for expressing their different points of view on this important and complex subject.

The reports bring an indispensable contribution to the debate on the increasing of competition in the sector concerned and constitute a basis on which to formulate the guiding principles of policy for the European gas market.

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COMMISSION
OF THE EUROPEAN
COMMUNITIES

DIRECTORATE-GENERAL FOR ENERGY

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REPORT ON THE PROCEEDINGS OF THE CONSULTATIVE COMMITTEE OF MEMBER STATES - NATURAL GAS (C.C.E.M.G.)

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1.0 INTRODUCTION

The European Commission, in its Communication to the Council COM (89) 334 final - SYN 206 dated September 6, 1989, decided to pursue consultations with all interested parties, in order to examine in depth whether third party access to the European gas transport system needed to be organized, and, if so, under what conditions, in order to guarantee the maintenance of security of supply and quality of service to consumers. It decided, for this purpose, to set up two consultative committees.

The one consultative committee on natural gas consisted of representatives of the gas industry, such as integrated utilities, gas producers, distributors, as well as large industrial users and small consumers and was called Professional Consultative Committee on Gas (PCCG). The other committee on gas consisted of representatives of the member states and their suppleants and was called Comité Consultatif Etats Membres Gaz (CCEMG). The members of the CCEMG are shown in Appendix A.

This report is dedicated to the work of the CCEMG.

An effort has been made to reflect the views of the delegates as they expressed them; however, when a point was presented by more than one representative, in more than one occasion, it has only been mentioned once in the text in an effort to avoid duplication.

1.1 Mandate of the CCEMG

The Committee was asked to assist the Commission in identifying the various elements (technical, economic and administrative) to be taken into account before the Commission considers if and under what conditions a system of third party access to the natural gas transmission and distribution networks might be implemented.

Several members of the CCEMG emphasized that Third Party Access (TPA) should be considered in the context of the significance of natural gas as an energy source for EEC member states, as well as in the context of a broader energy policy of the European Community.

The members of the CCEMG met several times to discuss and express, on the basis of issues papers prepared by the Commission, their views on the following topics:

- Effects of TPA on gas exploration and production.
- Effects of TPA on gas transportation.
- Effects of TPA on gas prices, consumption and competition.
- Modalities of the implementation of TPA.

2.0 DEFINITIONS

Third Party Access or TPA is a term used throughout this report to denote, in general, the ability of third parties (producers, consumers, gas merchants, or distributors) to receive and pay for transport and related services provided to them by a gas company. Definitions of the types of access that may be made available to these parties are provided in Appendix B. It is important to point out that TPA ought not be confused with the Transit of natural gas across Community gas networks and that these definitions are provided and used throughout this report as working hypotheses only.

The terms "open access" and "third party access" are used to denote service provided on a "first come - first served" basis versus the term "common carrier" which is used to denote service provided on a "pro rata" basis.

It was unanimously accepted that common carriage would not be an acceptable form of TPA because it would endanger the continuity of supply of existing customers. It was therefore decided that such a system should be rejected and was excluded from further consideration in this report. This did not imply that other forms of TPA might not effect, whether beneficially or detrimentally, the continuity of supply of existing customers.

The term "open access" is used to denote that all possible users (producers, distributors, small and large users) have access to pipeline services, versus the term "third party access" that is used to denote access to these services only to certain types of users (for example, only large consumers and distributors).

Throughout this report the term "third party access" or TPA is used generically to mean any form of access to pipeline services, such as open access or third party access.

3.0 UPSTREAM EFFECTS OF TPA ON GAS (EXPLORATION AND PRODUCTION)

With respect to the upstream effects on gas, a number of delegates submitted that exploration and production of oil and gas is a high risk, capital intensive activity. In addition, the development of gas fields requires additional infrastructure in the form of pipelines that are necessary to connect the gas field with the market. Thus, the large investments that are required frequently necessitate the existence of long term supply contracts as a precondition. A delegate from a state that is a major internal gas exporter mentioned that the development of small, marginal fields would have been very difficult in his country without the existence of long term gas sales agreements and certainty of sale in the short term. Her role as exporter within the European Community would have been and would be hindered considerably. It was further submitted that in a TPA regime, gas distributors would be more uncertain as to their market share in the long term and hence less willing to enter into long term contracts. This in turn could increase the risks and uncertainties for producers. There would be

reduced incentives to or interest in developing smaller marginal fields, particularly where a developed infrastructure doesn't already exist. In the presence of higher risks, producers would require higher return for their investments and thus, higher prices. Interest in exploration would concentrate in the larger more lucrative fields, leaving smaller marginal fields unexploited. This, it was argued, could have a negative effect on both prices and security of supply.

Another delegate submitted that an integrated Community policy would be needed in order to achieve a European gas market. Elements of such policy should include:

a strategy for exploration, production and storage of gas that would permit producing member states to make investment decisions within a Community perspective;

a Community policy for gas purchases;

a policy on security of supply that, in case of supply difficulties within the EEC, would coordinate the actions of all producing member states, as opposed to individual national measures.

Some delegates argued that their countries were highly dependent on gas imports and that all of this imported gas was supplied under long term contracts. One delegate added that a TPA regime would impose unnecessary risks with respect to security of supply. Another undesirable effect of TPA would be the possible increase of prices caused by a fragmented market supplied by an oligopoly. Others drew attention to the existing "take or pay obligation" of gas supply contracts and pointed out that, under any TPA scheme, these obligations would have to be respected and protected in order to avoid the possibility of serious financial problems they may cause to the utilities.

Another representative, drawing on their actual experience of operating TPA, commented that many of the theoretical drawbacks referred to by other delegates were not borne out in practice. Evidence in his country showed that TPA had no detrimental effect on the development of marginal fields of wharever size. He, supported by other delegates, argued that there was nothing special about the gas industry in its need to make major long term investments in exploration and production. Many industries faced similar investment decisions and infrastructure constraints on their ability to deliver their products into final markets. It was his view that long term supply contracts, which committed 100% of the reserves of a field and its associated infrastructure, were not an essential precondition before any offshore gas development could go ahead, though they were desirable in many circumstances and would not certainly be ruled out by TPA. Nor was it for risk taking industries, such as the oil industry, to be protected by monopoly retailing companies before they could profitably produce and deliver gas. The existence of TPA in their country has nor prevented long term contracts from being signed where this was the best way of developing a field (and most new gas supplies continued to be contracted on a long term basis) but it also allowed both producers and consumers the flexibility to opt for shorter term arrangements, where this was mutually beneficial.

4.0 EFFECTS OF TPA ON GAS TRANSPORTATION

With respect to gas transportation and access to transportation offered to third parties, the first delegate to make submissions on this topic pointed out that it is not necessary or possible to find identical solutions for all twelve member states with respect to open access. It would be more important, he submitted, to establish simple principles applicable to all twelve member states, and then let the individual states implement them in a way that would be most appropriate for them.

With respect to transportation and transportation capacity a representative commented that in his country TPA would be incompatible with national legislation. He added that present transport capacity would only be sufficient for national needs and would be insufficient to accommodate TPA. He further argued that new pipeline investments would be significant and could not be authorized without some market guarantee and that the notion of TPA is incompatible with the obligation to supply the public.

Another delegate pointed out that there is a need to improve the gas system, particularly its capacity in order to be able to cope with supply difficulties. He further argued that, as demand is expected to increase, contracts should be more aligned to market demands. Short term contracts should not be excluded and transporters should try to cater to consumers' needs, should not discriminate between customers and could only prioritize sales to certain "strategic" customers, as defined by member states, in cases of emergencies or shortfall.

Another delegate argued that gas transportation is not an independent operation. Changing transportation principles would affect the whole gas procurement - transmission - distribution chain. Looking at the European gas supply situation, he observed that when there exists an oligopoly of supply, a fragmented demand may lead to higher prices. TPA might also lead to unnecessary and excessive regulation. The need for TPA needs still to be proven and answers should not be given in a political vacuum. In the presence of existing antitrust legislation, both at the national and Community level, and in a free market economy, there is no need to regulate. He further added that relevant legislation in his country was liberal and allows anyone who wants to build a network to do so. There were no import monopolies. There are no legal impediments to build new pipelines or preventing a pipeline operator to make pipeline capacity available to third parties.

Other delegates pointed out that the uncertainty of pipeline investments under TPA could become a serious problem for countries that are attempting to introduce natural gas in new markets and questioned the possibility of a Community wide gas supply system. It was further suggested that special attention should be paid to the member states at the periphery of the Community with new immature gas markets requiring significant front end investments. Such systems should be allowed a transition period of sufficient time in order not to jeopardize the financial viability of such investments.

The next delegate pointed out that implementation of TPA would pose a number of problems (such as higher risk investments in production that could lead to the construction of sub-optimal size pipelines, the provision and pricing of back-up services, the difficulties of the young gas companies). He considers that these problems, that at first view don't appear to be unsurmountable, have to be examined carefully, particularly concerning security of supply, and that they cannot obscure the advantages of stronger competitive pressures and a more flexible gas market for the consumers.

5.0 DOWNSTREAM EFFECTS OF TPA (CONSUMPTION, PRICES AND COMPETITION)

In the context of natural gas production, TPA would make it possible for certain customers or distribution companies to select purchasing gas from the producer (or the gas merchant, or broker) of their choice, in principle anywhere inside or outside the Community, depending on transmission capacity availability. Such a scheme would also offer a wider choice to gas users and could also introduce a higher degree of competition at the level of natural gas production.

With respect to consumption of natural gas in the Community, the observation was made by all participants that demand for gas had grown significantly in the past twenty five years. The growth still continues and most participants acknowledged that it will be more difficult to meet future demand and that more reliance will have to be placed on imports in the future, as indigenous Community reserves and production will not be able to meet the growth in consumption. In this regard, as one delegate pointed out, attention should also be placed to another objective of European energy policy, namely diversification.

Another delegation pointed out that, up to now, the natural gas market has been a buyer's market, but the expanded use of natural gas indicates that the market is moving towards a seller's market. In such a case, one could question the consequences of introducing TPA and argue that direct access for the producers to the end user market would not necessarily lead to lower gas prices, but may in fact give the producers the opportunity to charge prices higher than today.

Delegates of member states with little or no experience with natural gas systems that are still under development expressed reservation about the potential benefits of a TPA regime and its potential to do better than present schemes. One delegate pointed out that in embryonic systems relying on one supplier and one gas company,. the introduction of TPA might create difficulties with respect to security of supply and back-up services and he added that some degree of market protection is necessary.

Regarding the impact of TPA on the level of security of supply to the final consumer, as it was pointed out earlier, there were two main views expressed. One was that TPA might not have a positive effect on supply security.

On the other hand, another delegate submitted that this is not the case in his country and added that his experience was that there was no effect on supply security to the customers in his country, particularly the smaller customers. He further submitted that, the type of TPA chosen would be important. If properly structured, it should stimulate new suppliers to enter the market and thus enhance both supply and competition. It should also allow consumers to choose the level of security that may be the most appropriate for their needs and/or consumption pattern.

The general feeling of the participants was that competition in general is beneficial. However, there were different views expressed with respect to the necessity to introduce TPA in order to achieve more competition. A number of delegates challenged the general expectation that the introduction of more competition through TPA would lead to lower prices. It was also pointed out that a fragmented demand may lead to higher prices. One delegate stated that observing price developments in countries where some form of TPA has been introduced, leads to the conclusion that the usefulness of TPA to obtain lower prices is yet unproven. Another representative questioned whether more competition would to be consistent with other goals of European energy policy, such as security of supply. In this regard the same delegate expressed the view that some basic competition rules might be necessary to govern the gas market. As gas market share increases, he submitted that there would be a need for prices to remain competitive in order to allow gas to maintain and even improve its present market share. As another delegate pointed out, competition could be achieved in different ways, for example, with competitive pricing at the burner tip, with governmental or public control of prices and/or competition, or with TPA. He added that the best way to intervene depends on historical and specific conditions that differ from country to country and that there is no evidence that TPA would be more effective than other systems.

On the other hand, another delegate emphasized that there are significant benefits to be realized from the introduction of more competition, inter-fuel and more particularly gas to gas competition. Customers of new suppliers stand to benefit, because new suppliers would be expected to lower prices in order to enter the market and remain competitive. Customers of existing suppliers are also expected to benefit, as the mere threat of competition would force the traditional suppliers to adjust their prices in order to prevent their customers from going elsewhere. Increased gas to gas competition is expected to have two more additional benefits, namely the "de-coupling" of gas prices from oil prices and the creation of a more independent natural gas market, as well as the increased penetration of gas in certain traditional and new markets, such as the power generation market.

All delegates agreed that increased gas penetration, independent of the way it were achieved, would have a positive and beneficial effect on environmental objectives.

6.0 MODALITIES OF IMPLEMENTATION OF TPA

The first delegate made reference to significant changes that have occurred and continue to occur in the natural gas market, such as new opportunities in East Europe. The introduction of TPA would necessitate some form of regulation. However, it was argued that neither the necessity nor the degree of TPA to be introduced had been decided and it was therefore too early to attempt to define the modalities at this point in time.

Another representative submitted that his country did not have any experience in the area of TPA and that discussions continue in an effort to determine the course of action to be taken. With respect to the overall need for regulation, his view was that private arrangements between the parties concerned would be preferable to regulation. He pointed out the need to establish a general framework for competition and then allow the market to operate. He suggested that the voluntary system that may be adopted to facilitate transit may also be suitable for TPA by adding a conciliatory body that would be empowered to resolve disputes.

Despite the presence of a national monopoly in his country, and taking into account the actual situation in Europe today, he submitted that three schemes were being examined in parallel in order to enhance competition and integration of the natural gas markets:

- A scheme of cooperation between transmission companies in order to enhance international transit. That would include the systematic use of negotiations of all interested parties in the form of a consortium that would include all third parties and possibly producers, the development of exchanges between companies and a common management of networks, storage and take or pay obligations.

- A scheme of competition amongst transmission companies.

- A scheme of competition that would allow more competition amongst producers and transmission companies by allowing them to supply directly to the industrial sector and distribution companies.

The competitive pressure of the first scheme would allow the companies to stay in control of their markets and, thanks to a greater cooperation, be able to reduce costs.

He argued that cost and price transparency would be essential for a TPA system, but it should respect the confidentiality of commercial information. One should let the market determine and decide the need to build additional capacity and allow the operating companies to continue providing services such as back-up, without disturbing the equilibrium that exists in Europe today. Transportation charges should be determined on the basis of total costs and that an overseeing body, or arbitrator, would be an acceptable way to resolve disputes at Community level.

Another representative, drawing attention to the significant differences that exist between member states, mentioned that in his country, a regulatory scheme to govern the development of the national gas grid has been implemented. Consumer prices are regulated in an effort to promote gas and make it more attractive than diesel and fuel oil. In such an environment the potential benefits of a TPA regime may not be passed to the consumer for some time, in order to allow the recovery of the initial large capital costs. He concluded by stating that there would be need for a dispute resolution mechanism.

Another delegate submitted that, taking into account the difficulties raised elsewhere in this report, it may be preferable to start by studying the possibility of introducing an experimental phase of TPA to a limited number of customers. This category could be the large users using gas as feedstock. On the same point, another delegate suggested the possibility of introducing, perhaps on an experimental basis, a system of TPA first to the large industrial consumers and later perhaps to the small consumers. Taking into account that it should be possible to stop such an experiment, if it proved unsuccessful, one should not create a regulatory authority at Community level that could, with its inertia, prevent turning back. During such an experimental phase, it would not be necessary to institute a "back-up" obligation; the large consumers who use gas as feedstock, he added, do not appear to require as much security of supply for gas as they do for other materials.

The opening up of the grid to third parties would necessitate, in his view, to have a regulatory mechanism at Community level, but he added that this mechanism should be light and flexible. It could, for instance, be a committee of the type of committee of professionals and experts envisaged by the draft Gas Transit Directive which could deal with disagreements between a transporter and a consumer or another transporter on the conditions of gas transport. He finally suggested that in a system of open networks, it appears necessary that the states could control gas imports, for reasons of security of supply. The states should have the means to avoid having a gas exporter acquire a significant position in their gas plan.

The next delegate argued that TPA induced competition would require some regulation. It suggested that only the monopoly aspects of the natural gas business should be regulated and at this point it may still be too early to say what degree of regulation is needed and at what level. There are advantages in having some regulation at the national level and advantages as well as disadvantages of having regulation at Community level, such as slow procedures and regulatory over-burden.

With respect to the form of TPA that would be able to achieve more competition without onerous regulation, he drew attention to the UK regime and found it promising. He further added that market forces would determine the need for new pipeline capacity and that functions such as ensuring back up, price transparency (that respects commercial confidentiality), the setting of transportation and related charges and dispute resolution should be part of the responsibilities of a regulatory authority.

The next representative submitted that, before discussing the modalities of implementation of TPA, the nature of the energy market, and more specifically of the natural gas market, need to be taken into account. He added that the principle of subsidiarity is of fundamental importance and when discussing what should be regulated at Community level versus the national level, Community involvement should be kept at a minimum, so as to leave maximum space for member states to move. The Community, he suggested, should establish a set of general principles aiming at achieving Community energy policy, and the member states should be left to implement these principles by choosing their own modalities. This would be the way to achieve maximum efficiency and do justice to both industrial and consumer needs.

Another delegate submitted that a general approach to implement TPA should include:

- a minimal amount of regulation, only where needed
- the introduction of a set of principles that will apply Community-wide and could include the following:
  - establish the basis on which TPA should be made available, e. g. first come-first served.
  - ensure that TPA should be made available to parties wishing to use all or any part of the pipeline network on a non-discriminatory basis, recognizing that member states may wish to "protect" certain categories of customers and limit TPA to customers above a particular threshold of consumption.
  - ensure that pipeline operators should receive a reasonable level of compensation for making transportation and related services available to third parties, without penalizing or discriminating against these customers.
  - decide whether transporters should be obliged to build additional capacity when the system is genuinely full.
  - if the existing system could not be expanded to overcome bottlenecks, member states to be willing to authorize the construction of new pipelines.
  - ensure regulation is kept to a minimum, make arbitration available to resolve disputes and allow the market to determine and resolve commercial issues such as terms of contracts, basis of tariffs etc.
  - allow flexibility in the system to evolve over time and adjust to market needs as they develop.
- leaving the implementation of these principles to national authorities

It was the view of the same representative that the implementation of TPA doesn't necessarily require the creation of new bodies. National departments of Energy could carry out such a function at the national level and existing Commission services at Community level. He added that even for the implementation of the Gas Transit Directive, some regulatory principles may have to be established by the Commission. It was finally his assessment that any regulatory function could be carried out on an exception basis, i.e., there is no need for continuous involvement, unless a dispute arises that requires the regulator to intervene in order to resolve it. With respect to price transparency, he argued it was one of the fundamental principles necessary to ensure non-discrimination, however, he added, cost transparency for the supply of natural gas as a commodity (excluding transportation and related services), would neither be needed nor necessary in a competitive market. With respect to transportation charges, he suggested that maximum charges should be set, and that they should cover costs. However, the question still remained whether it should be marginal or average costs that should provide the basis for setting transportation and related charges.

7.0 SUMMARY AND FINAL OBSERVATIONS

7.1 Areas of agreement

The discussions did not put in question the argument that the objective of the Internal Energy Market:

- should have beneficial consequences for consumers in the Community and for the competitiveness of its industry.

- should also be an important factor in the Community's security of energy supplies;

During the discussions another important argument made was that means other than TPA were also able to favour the continued integration of the Community natural gas market. Among the means mentioned were, first, the necessity to increase at Community level convergence in different domains (such as fiscal, environmental, accounting policies, standardization etc.) and second, the elimination of trade obstacles incompatible with the Treaty of Rome: in this context some delegates made reference to import and export monopolies.

A third important argument that was made implicitly during the discussions is that long term gas supply contracts constitute an important guarantee for the security of natural gas supply.

It is also fair to say that, in the context of TPA, and only if it were to be introduced, there was agreement on the following four aspects:

- first, it was agreed to exclude decisively any form of "common-carrier", as it implies a danger of pro rating existing contracts and thus a danger to the continuity of supply.

- second, its modalities of implementation should be based, as much as possible, on simple and flexible principles:

  as much regulation as necessary, but keep it to a minimum to avoid unnecessary bureaucracy;

  priority to regulation at national versus Community level;

  experimentation and evaluation;

- third, special provisions would have to be drawn concerning existing contracts and particularly, existing "take or pay" obligations in order to avoid financial difficulties to those utilities who have to honour these obligations under existing contracts.

- finally, the necessity to consider particular protective measures for investments made in order to introduce or expand natural gas in immature or new markets.

7.2 Remaining differences

In general terms, a number of delegates kept repeating that the traditional and even young natural gas systems that exist in most member states have proven their efficiency. This was not necessarily the case with a system such as the one existing in the UK: as interesting as it may be, this system was influenced by the particular circumstances of that country and its implementation was too recent to allow drawing any irrefutable conclusions. They kept reminding that they saw no need to replace a well established system by a system that has yet to prove itself.

On the other hand, it was pointed out by two delegates that the UK system has not resulted in any of the disadvantages, referred to by other delegates, attributed to the introduction of TPA. The UK did provide a concrete example of how such a system worked in practice, whether or not such a system proved an exactly suitable model for a more widely based Community system.

Always speaking in general terms, many delegates argued that the internal Market for natural gas (and the introduction of some form of TPA) did not necessarily presuppose a modification in the corporate structure of the gas industry. In other words, the actual diversity of these structures would not constitute in itself an unsurmountable obstacle in the achievement of the internal Market for natural gas.

It is clear that the debate brought to light the persistence of appreciably divergent points of view on a number of other issues and more specifically on the possible effects of a TPA system.

a) Possible effects

These differences of opinion may be summarized as follows:

i) Concerning the impact of a TPA system on the exploration and production of natural gas.

Certain delegates feared that a TPA system would add additional uncertainty and would subsequently have negative effects on exploration and production activities. The need for long term agreements (with take or pay clauses) is seen by them as a necessary condition for the development of gas fields. Furthermore, the absence of a secure market would result in marginal fields being left unexplored or undeveloped.

The opposite view was expressed by another delegate from a member state which has actual TPA experience. He indicated that, while long term contracts are still being entered into after the introduction of TPA, the new regime has also allowed both producers and consumers to enter into shorter term contracts, when it was mutually beneficial to do so. His view was that no negative effects have been experienced so far, concerning exploration and production of fields of any size. Furthermore, due to the increased range of potential future buyers, it could be argued that a TPA regime might have a positive overall effect on gas exploration and production.

ii) Concerning the impact of TPA on the transportation of natural gas

Certain delegates argued that the integrated character of the present system allows for maximum rationalization of activities at the lowest cost. Furthermore, the transportation function is, in their view, only a part of an integral system of operations (including services such as back-up, storage and load balancing) which, by the nature of its integration, results in better quality of service and higher security than that offered by a TPA regime. They added that a fragmented demand for gas caused by TPA would have a negative effect on new pipeline investments.

On the other hand, it was argued that a more open market under a TPA regime would result in a better allocation of resources and a greater scope for efficiency improvements resulting from competitive pressure.

iii) Concerning the impact of TPA on prices and competition

Certain delegates expect that the growing gas market will soon change into a sellers' market which could lead to higher prices in the case of fragmentation of demand under TPA, and the strengthening of the position of the producers. Another argument that was presented was that TPA would introduce serious discrimination by asking captive customers, or customers with little negotiating power, to pay for the benefits that would be obtained by the large consumers. On the other hand it was argued that, by increasing exchanges and by increasing the opportunities offered to lower cost sources of supply, TPA would allow the reduction of natural gas prices.

Furthermore, TPA would lead to a closer relationship of prices with costs, would reduce the risk of discriminatory cross-subsidies between consumer types and would thus lead to a more rational price structure that would be more favourable to general economic development.

b) **Modalities**

A certain number of delegates felt it was premature to discuss the modalities of introducing a TPA system. In this context, some felt that one should wait to see the results of the measures being adopted (Price Transparency Directive) or proposed (Gas Transit Directive) at Community level.

However, concerning the possible modalities of implementing a TPA scheme, two interrelated issues, even though only briefly discussed, appeared to be the subject of divrging opinions:

- the advantages and particularly the feasibility of unbundling the various activities of the gas sector (supply, transmission, distribution).

- cost transparency.

7.3 General observations

The CCEMG fulfilled its mandate practically within the set deadline, despite the fact that first, some delegates felt they were under fairly strong time pressure, and moreover, that the mandate of the Committee should have been expanded to include a comparison of the relative merits of a TPA system with the more traditional systems of supply.

The debate was frank and was conducted in a positive and open atmosphere. In this regard, it is important to underline that, even though they frequently expressed themselves more as experts rather than national representatives, the delegates accepted in this report the principle of anonymity which indicates that the positions expressed were not necessarily fixed and irreversible. This agrees with the intention of the Commission, when it created the Consultative Committees to deal with the issue of TPA.

As it is natural, the discussions in the frame of CCEMG were less technical than those of the professional committees; on the other hand, concerns of energy policy were always at the forefront of various interventions.

Finally (and without prejudice to what was said in the second paragraph of this chapter), it appeared that, in terms of balance of opinions, the sceptics of the possible advantages and modalities of implementing TPA outnumbered those who were favourable. However, a number of delegates did not wish to express themselves neither in favour nor against a TPAsystem at this stage.

Commission Services, in accordance with their task, remained neutral at this stage on all aspects of the problem.

APPENDIX A

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APPENDIX B

Glossary of terms

Access rights	Right to the use of the transportation grid in a TPA system.
Broker/Trader	An intermediary who buys gas from whatever source for its subsequent resale.
Common carriage	Theoretical definition of common carriage includes the allocation of capacity pro rata among all applicants. This concept is excluded in the definition of TPA used in this report.
Cross subsidisation	Process of charging an unjustifiably low price to customer groups and compensating for this by charging higher prices to other customer groups.
Distribution	The transport of natural gas on lower pressure local networks for delivery to final consumers.
Downstream	Gas operations relating to transmission within the European Community, distribution and related services as well as gas marketing.
Integrated gas company	As merchant gas company, but also performs the function of distribution.
LDC	Local distribution company.

Merchant gas company	Gas company that includes the following functions: bulk purchase from producers, transmission and sale of gas.
Region	The geographical area served by a particular grid.
Supply	The delivery of natural gas to final consumers, including arrangements for purchase, transmission, storage and distribution.
Take or Pay Obligations	Financial contractual obligation of a natural gas buyer to pay for a certain minimum quantity of gas irrespective of whether he takes delivery of that gas.
Third Party Access - TPA	A scheme providing for a qualified obligation on companies operating natural gas transportation facilities to offer terms for the use of their system.
Transmission	The transport of natural gas on the interconnected high pressure grid.
Unbundling	Disaggregation of charging, accounting or management of particular operations, or even ownership of an integrated or partly integrated gas company.
Upstream	Gas operations relating to exploration, production and purification of natural gas up to the delivery point to the transmission grid in the European Community.

COMMISSION
OF THE EUROPEAN
COMMUNITIES

DIRECTORATE-GENERAL FOR ENERGY

FINAL REPORT

PROFESSIONAL CONSULTATIVE COMMITTEE

ON GAS

DG XVII

APRIL 1991

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PCCG Committee Procedures

(Note by the Chairman)

In arranging these consultations it was our aim in the European Commission to bring about a genuine discussion between the members of the Professional Committee, rather than simply to ascertain their individual views or those of the interests they represented. That could in any case have been achieved by correspondence or bilateral meetings. From the beginning, therefore, it was clear that the Committee's Report should both identify the key issues, as required by the terms of reference, and clarify the areas of agreement or disagreement between the participants.

Against this background it was essential that the text of the Committee Report should be based on thorough discussion of all aspects of the Third Party Access (TPA) question. After a first procedural meeting in May 1990, therefore, the discussions were divided into four subject areas:

- Consumption, Prices and Competition
- Gas Transport
- Exploration, Production and Gas Purchases
- Modalities and Regulation.

For each of these areas a first discussion was held on the basis of a non-exclusive agenda sent out in advance by the Commission, in its role as Committee Secretariat. The Secretariat then prepared and circulated to Members a draft Chapter for the Committee Report dealing with that subject .

This draft text was then discussed in a second Committee meeting, revised accordingly, circulated for written comments and revised for a second time. A few further changes were made to these Chapters at a later stage, to take account of the final phases of the Committee's discussions.

Following the discussions of the four subject areas, the Secretariat prepared an Executive Summary for the overall Report. In successive versions, this text was discussed three times in the Committee and twice circulated for written comments, with revisions at each stage.

To illustrate the extensive nature of these consultations, the effect of TPA on consumption, prices and competition, for instance, was discussed in both the Committee's June and July 1990 meetings. Written comments on successive draft texts of the Chapter dealing with that subject were requested in September and again in February 1991. The subject of consumption, prices and competition was returned to in the three Committee discussions of the Executive Summary in January, February and March 1991 and in Members' written comments on that Summary text.

The Report of the Professional Consultative Committee on Gas is therefore a synthesis of views exchanged in the Committee's discussions and/or expressed in written comments. As such, it should not be taken to reflect in detail the views of any individual Committee Member.

Some Committee members, however, requested that the published report should be accompanied by position statements setting out their views or those of their organisations on the TPA issue. These statements are annexed to the PCCG Report, but were not discussed by the Committee and should not be taken as forming part of the Report.

* * * * * *

CONTENTS

PCCG Membership

Chairman

M. Clive Jones - Deputy Director General for Energy, European Commission

Vice-Chairman

M. Hans Maters - Head of Unit "Hydrocarbons"- Directorate-General for Energy, European Commission

Members	Position	Proposed by(*)
Mr. Burckhard Bergmann	Vorstandsmidglied Ruhrgas	EUROGAS
Mr. Paul Emaer	Secrétaire général adjoint CSF - Confédération Syndicales et Familles	BEUC
Mr. Paul Hatry	Président du Comité "Politique énergétique" de l'UNICE	UNICE
Mr. Dick de Jong	Head Natural Gas Division Europe - Shell Int. Petroleum Mij., B.V.	E&P FORUM
Mr. Niek Ketting	President Directeur Samenwerkende Elektriciteits-Produktiebedrijven (N.V. SEP)	UNIPEDE
Mr. Peter Lewis	Assistant Director British Gas	EUROGAS
Mr. Manzanedo	Consejero Ejecutivo Catalana de Gas, S.A.	CATALANA DE GAS, S.A.
Mr.Paul-Robert Morin	Président de la Commission Energie - CGPME	UEAPME-CGMPE
Mr.Jean-Pierre Neirynck	Administrateur délégué Distrigaz	EUROGAS
Mr.Jacques Plénard(1)	IFIEC Europe	IFIEC

(1) Having succeeded Mr. von Haken (since 1.07.1990)

Mr. Ian Powe	Director Gas Consumers Council	BEUC
Mr. George Verberg	Commercial Managing Director Gasunie	EUROGAS
Mr. Jean-Pierre Vergé	Directeur Gaz Naturel Soc. Nat. Elf Aquitaine	E&P FORUM
Mr. W.K. Wiechers	Directeur N.V. Provinciale Noordbrabantse Energie Mij.	VEGIN
Mr. Bradley Williams	Manager of Natural Gas Ventures - Mobil Europe Inc.	E&P FORUM
M. Alan Wilson	Director Energy - DOW Europe, S.A.	CEFIC
Mr. Klaus Wollschläger	Mitglied des Vorstands Wintershall AG	WINTERSHALL AG

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Royal Institute of International Affairs - London

Secretariat

Mr. H.U. Beelitz - Chief of Secretariat
- Head of Unit - Task Force 1- European Commission

Mr. H. von Bose - Principal Administrator
Mr. A. Garcia Fragio - Principal Administrator
Mr. P. Coroyonnakis - Expert

Administrative matters

Mr. E. Brakels - Assistant

Substitutes	Company	Proposed by:
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Mr. U. Cropp	Wintershall AG	WINTERSHALL AG
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Ms. L. Davies(1)	Gas Consumers Council	BEUC
Dr. P. Gavens	ICI C&P Group	CEFIC
Mr. J. van Hasselt	VEGIN	VEGIN
Mr. J. Meeder	Gasunie	EUROGAS
Mr. Moore	British Gas	EUROGAS
Baron A. Rolin	Intercom S.A.	UNIPEDE
Mr. H. Schroeder	Zentralverband Deutschen Handwerks	UEAPME
Mr. P. Storm	D.O.N.G	E&P FORUM
Mr. W. Tulnder	Hoechst Holland N.V.	UNICE
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Mr.T. Verougstraete(2)	Petrofina	E&P FORUM
Mr. D. Williams	Rhône-Poulenc - UK	IFIEC
Mr. J. Winderickx	Distrigaz	EUROGAS

(1) Having succeeded Ms. R. Ouseley (since 1.01.1991)
(2) Having succeeded Mr. Spann (since 15.11.1990)

Representatives of members who attended meetings:

Names	Company
Mr. F. Balocco	DOW Europe, S.A.
Mr. M. Berger	Elf Aquitaine
Mr. T. von Haken	Carl Freudenberg
Mr. K. Howson	DOW Europe, S.A.
Mr. Jansen	Gasunie
Mrs. M. Janssen	Catalana de Gas, S.A.
Mr. U. Neumann	Ruhrgas
Mr. T. Sponheuer	Ruhrgas
Mr. A. Woning	Shell Int. Mij.

EXECUTIVE SUMMARY

1. The concept of Third Party Access (TPA) is that buyers or sellers of gas, or selected categories of buyers and sellers, would have the right to be offered transport services by the companies which own the Community's gas pipeline systems. In principle, where capacity was available, this would make it possible for consumers or distributors to buy gas through the pipeline system from a range of existing or new suppliers, thus removing a key barrier to competition within the natural gas market. A number of important doubts have been raised however about the effects of TPA on the gas market, and on whether competition would in practice be enhanced.

2. The Commission asked the Professional Consultative Committee to identify the issues arising from the concept of Third Party Access, rather than to recommend whether or not TPA should be introduced in the Community's gas market. The terms of reference agreed by the Committee at its first meeting, therefore, were to :

   "identify and present the main technical, economic and administrative considerations which should be taken into account in Community policy on whether and, if so, in what form and by what means third-party access to gas transport systems should be provided."

   It was agreed that both transmission and distribution systems should be covered by this remit. The Committee was not asked to consider legal questions.

3. The results of this work are presented in Chapters 2 to 5 of this Report. But the discussions in the Committee have shown that there are major differences of view about the advantages or disadvantages of the Third Party Access approach.

4. These differences of view centre on three main issues :

   - would <u>security of supply</u> be jeopardised by the introduction of TPA, or would the new market situation still attract the necessary gas supplies and preserve security of supply for the final consumer ?

   - would the general level of <u>consumer gas prices</u>, and the prices paid by particular types of consumers, be higher or lower as a result of TPA ?

- Would the introduction of TPA lead to excessive regulation or could regulation be kept within reasonable limits ?

5. These three dominant issues of security of supply, consumer prices and regulation are discussed further below. Another important issue, the impact of TPA on existing and prospective Take or Pay agreements, is discussed under both the first and third headings. Other questions such as pipeline capacity and transport charges are dealt with under the heading of regulation.

Supply and Security of Supply

6. At present the Community's gas requirements are met from a variety of sources within the Community (mainly Netherlands and the UK) and outside (mainly Norway, USSR and Algeria). It is common ground that gas demand is likely to rise substantially in the next 10 to 20 years, and that to satisfy this demand additional gas would need to be produced within the EC and purchased from elsewhere. The view of the gas producer representatives and some others on the Committee is that the introduction of TPA would create such uncertainty as to jeopardise gas exploration and development and the availability of supply, both within the Community and in regard to external suppliers. They believe that long-term security of supply can best be assured by the present system in which the gas companies, with their effective monopoly of final gas sales, can aggregate their consumers' demand and provide large offtake (take or pay) guarantees. This is felt to be particularly important for major investments in offshore and other high cost fields, or in long-distance pipeline delivery systems(1). There would also be important consequences if a move to TPA prevented compliance with existing take or pay contracts (see paragraph 23 below).

7. There can be no doubt that long-term take or pay agreements constitute a highly effective means of reducing upstream investment risks. The question is whether sufficient gas supplies would still come forward in a TPA situation. Some Committee members believe that this would be the case and do not accept the views expressed in the preceding paragraph. They argue that many consumers or distribution companies could provide offtake guarantees (or take over a part of existing take or pay

(1) These views were supported by the Norwegian State oil company, STATOIL, in an informal presentation to Committee Members.

agreements) and that some upstream companies with no downstream gas interests might increase their gas exploration and development efforts if they were no longer restricted to selling to a small number of purchasers. Such companies might be interested in entering a more open and growing downstream market themselves, as has happened in the UK. Producers with downstream interests would no doubt remain active in bringing forward gas supplies. In principle, external suppliers could also be expected to remain strongly interested in selling gas into the large and growing Community market, depending on prices and other contractual conditions.

8. The view of the merchant gas company representatives and some others on the Committee is that upstream purchase prices would tend to be increased by the introduction of a TPA regime. They believe that, at a time of growing demand, TPA could shift market power in the direction of the limited number of external suppliers by 'fragmenting' demand so that many more buyers would be bidding for supplies, rather than just the present small number of major gas companies. Some other Committee Members, however, take the view that greater competition in the downstream market would exert strong downward pressure on upstream purchase prices. Ultimately, the level of prices over time would of course be that necessary to bring supply and demand into line. Higher prices would tend to encourage upstream activity but reduce market penetration in the face of competition from oil and other fuels, whilst lower prices would work in the other direction in both respects.

9. The issue of supply security also has a downstream aspect. The merchant gas companies stated that if TPA were introduced they could no longer invest in reserve pipeline capacity and keep capacity available for dealing with unexpected supply difficulties and ensuring continuity of supply to local distribution companies. They also argued that TPA and unbundling of specific downstream functions would prevent the optimal use of the pipeline system. Lastly they argued that TPA customers would not automatically be able to obtain back-up gas supplies from their local supplier if their contracted source of supply failed. Some others on the Committee, however, did not accept these views and believed that a TPA situation would still bring forward reserve pipeline capacity eg. through a growth in interruptible sales. These issues are discussed further below.

Consumer Prices

10. The Committee identified considerable differences of view about the effect of TPA on the general level of prices paid by consumers for gas, and on the relative price levels for different types of consumer.

11. In the current situation most gas consumers, large and small, pay prices related to (or just below) the cost of using the alternative fuel, usually oil. Where there is a real possibility of consumers changing to another fuel in the short term (fuel switching) or longer term (changes in equipment), it is clearly improbable that prices could rise to and stay at higher levels over any sustained period of time without reducing market sales, even if the merchant gas companies' expectations about upstream prices and higher system costs proved correct. Some participants, however, argued that in the expanding market which is foreseen it would be open to companies to serve only higher price sectors of the market.

12. Some Committee members believe that the general level of consumer gas prices might be lower in a TPA situation, as an inevitable consequence of TPA opening the way for gas-to-gas competition and for new sellers to enter the market. They argue that oil-related pricing could no longer be maintained in a situation where consumers had a choice of changing suppliers, even if they did not exercise that choice, and that to move away from that system of pricing would be desirable in terms of lower costs for consumers and a stable level of gas prices less subject to the vagaries of the international oil market. They underline the favourable consequences this would have in reducing the Community's reliance on imported oil, and stress also the environmental quality advantages of increased use of gas, for instance in CHP schemes.

13. The merchant gas company and producer representatives, on the other hand, believe that there would not be much scope for gas-to-gas competition or for new sellers entering the market because, inter alia, of limitations on the production and deliverability of new gas supplies. They argue therefore that TPA would not have any downwards impact on consumer prices. They also say that many consumers would want to continue to pay oil-related prices to ensure that their energy costs are kept in line with competitors elsewhere. Lastly, they argue that this method of pricing ensures a high market penetration for natural gas by guaranteeing that the prices of the alternative oil products in the various market sectors are always undercut.

14. Some participants believe that the relative prices for different classes of consumer would not change much unless TPA competition did have an effect on overall consumer price levels. The merchant gas companies and others do not believe that this is likely. They argue that any price reductions would mainly benefit larger consumers eligible for TPA, and that smaller consumers might even pay more because of an increased risk of cross-subsidisation and

higher costs likely, in their view, to arise from TPA. Others in the Committee contend that all consumers might well benefit because of a reduction in the general level of gas prices, and that regulatory authorities would, as is already the case in some countries, guard against cross-subsidisation risks. They also point out that local distribution companies could, with TPA, compete for lower price gas supplies and pass on benefits to their smaller consumers. This last point was however contested by other participants, who asserted that LDC's would not be in a position to compete for lower priced gas supplies.

15. It should also be noted that if TPA competition were effective the prices paid by TPA consumers would tend to bear a closer relation to supply costs than is at present the case. This would mitigate against any attempts to establish pricing patterns for these consumers in accordance with regional or industrial policy aims. It could also lead to a greater 'regionalisation' of reliance on particular gas sources, although this could reduce overall costs.

Regulation

16. Although TPA could have consequences for all sectors of the gas market, the extent of direct TPA activity would depend in part on how many and which types of consumer (or distributor) were eligible to enter into such arrangements. It is inherent in the concept that those who became eligible for TPA should no longer need to be covered by price controls or supply obligations where those exist today.

There could be three categories of eligibility for consumers or distributors:

- those declared eligible for TPA;
- those who could choose to be eligible but who would otherwise remain covered by their existing regulatory arrangements;
- those declared ineligible.

The Committee felt that, at least initially, many smaller consumers would wish to continue to benefit from price controls and supply obligations, and would therefore be unlikely to opt for TPA even if they were included in the second category. Some Committee members felt that household consumers should definitely be excluded on grounds of supply security, taking account of safety risks, and to reduce regulatory complexity. Another view was that such consumers should not be permanently excluded; they might be excluded initially with the possibility of being brought within TPA later in the light of experience of the new market situation.

17. Although the introduction of TPA would, as noted in the previous paragraph, reduce the need for some types of regulation for certain categories of consumers, there are a number of problems inherent in the TPA concept which would require new regulatory intervention. These mainly concern transport, in particular the availability and allocation of transport capacity and the question of transport charges. But there would also be some related issues including arrangements for dealing with supply interruptions and, possibly, access to gas storage or blending facilities. It would be important to ensure that the introduction of TPA did not lead onto regulation at the level of gas production, which could have adverse consequences for upstream activity.

18. There was general agreement that regulation should be kept to a minimum, although many Committee members felt that this would not be feasible and that regulation would tend to increase over time. One approach discussed in the Committee was to limit the need for case-by-case intervention by laying down clearly in advance the main principles of a TPA regime in the form of a legally binding Community instrument. Regulatory interventions would then need to deal only with disputes about the correct implementation of the principles, always provided that the principles were sufficiently comprehensive. It might also help to provide for some form of independent arbitration of certain types of dispute before recourse to the regulator. Doubts were, however, raised on whether this approach could deal satisfactorily with the problems which could arise in a TPA situation. In particular, it was argued that each case would involve different details which could not be anticipated in advance.

19. As an alternative to the approach outlined in the previous paragraph, the possibility was raised of TPA legislation based on the prevention of abuse by undertakings dominating the market. Such abuse regulation would be, from the viewpoint of both procedures and principles, an element of cartel law. It would leave the conclusion and contents of transmission contracts to the parties involved, thus providing scope for varying solutions. Only in individual cases of refusal to grant access on reasonable terms, would the relevant authorities investigate and take corrective action. They would do so on the basis of general predetermined criteria indicating what situations should be considered as abuses of dominant position. The Committee did not discuss in any detail the arguments for and against such an approach, or its legal implications.

20. The Committee did not attempt to define the details of the regulation which would need to accompany TPA. But some of the key parameters for dealing with the issues mentioned in paragraph 17 above were discussed, and are outlined in more detail in Chapter 5 of this report.

21. On transport capacity there would clearly have to be an equitable system for identifying and allocating spare pipeline capacity, where this was insufficient to deal with new transmission needs, and for ensuring that capacity could still be made available to deal with emergency situations. There might also need to be some means of ensuring that the development of gas pipeline systems over time took account of TPA as well as of the merchant company's own sales. It was however contested whether these aims could be achieved satisfactorily in a complex and highly interconnected pipeline network.

Transport charges should, according to some Committee members, be based on a clear published scale of charges derived from separately accounted (unbundled) transmission costs. The merchant companies felt however that this would not be feasible, and raised the possibility of allocating capacity by market value through a bidding process. They also asserted that cost allocation for the purposes of setting transport charges would be complex, arbitrary and likely to cause market distortions. In addition they argued that published and transparent charges would damage the marketability of natural gas.

There was also discussion of whether it should be an obligation, where gas and pipeline capacity was available, for merchant gas companies to provide back-up supplies to TPA customers where their contracted source of supply failed and, if so, on what terms.

22. There was agreement in the Committee that in a TPA situation regulation should be carried out at both Community and national levels. It would be more effective and appropriate, and consistent with the principle of subsidiarity for the Codes of Principles to be drawn up and implemented by Member States' authorities, on the basis of Community principles. A Community role would however be necessary to deal with any international problems arising from cross-frontier TPA transactions, and to ensure that the harmonisation of national rules was effective.

Other issues

23. The problem of implementing and regulating a TPA regime would certainly be eased by providing for transitional arrangements or a phased introduction of TPA. It would probably take some time before the number of TPA transactions grew to significant levels, but the market's reactions to that possibility might have an important indirect effect at an earlier stage. The Committee did not discuss possible types of transitional arrangements, but identified some of the issues on which such arrangements might be necessary.

One sensitive area for the transition would clearly be the security of investments already made and the impact on related contractual obligations. Within that heading, as discussed in paragraph 6, there would be the particular problem of Take or Pay Agreements, both from the point of view of the sellers and of the merchant gas companies who might become liable for large compensation payments if TPA competition prevented them fulfilling their offtake commitments. This problem might therefore require specific transitional arrangements to the extent that the relevant Agreements, often of very long duration, could not be renegotiated or transferred to other buyers. The current and future market growth and possibility of direct sales by producers could help with this situation. It is however the position of the merchant companies and the producers that Take or Pay agreements would remain essential for future gas supply. They do not believe that transitional arrangements could solve the Take or Pay problem.

There would no doubt also be claims for consideration under transitional arrangements in relation to recent infrastructure investment, the viability of which might be affected by a TPA regime, either in Member States where there had not previously been a natural gas industry or for extensions to already developed systems.

24. Although not directly within the Committee's remit, it was noted at a number of points in the discussions that there could be a case, particularly if a TPA regime were introduced, for removing other relevant barriers to trade and competition, including restrictions on the right to import or export natural gas (within the Community and externally) and any limitations on who could in principle construct gas pipelines or purchase gas from producers. The industry has also pointed out consistently that there are other differences in national law or fiscal arrangements which would significantly distort competition in the gas and energy markets, and argued that these should be removed before any introduction of TPA. The other view was that such differences could be 'driven out' by the effects of TPA competition, although the Commission would need to consider the case for remedial action at Community level if that proved not to be the case. The industry also expressed strong concern about the possible effects, in a TPA situation, on competition in general, and on competition between gas companies, of the differing industry structures in different Member States.

25. It is also important to note that the Committee's discussions were limited to the issue of access to inland gas transport systems. Questions were however raised on whether it would be

necessary or justified to provide access also to associated facilities such as offshore gas pipelines, treatment terminals, liquefied natural gas (LNG) installations and gas storage or blending facilities. Each of these cases raises specific and complex arguments which the Committee was not asked to address in this Report.

26. Finally, it is important to recognise that the success of any introduction of TPA in the Community would depend both on the practicability of the system adopted and on the efforts of all concerned to make the new system work.

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CHAPTER 1

INTRODUCTION

1. In September 1989 the Commission sent a Communication to the Council on the subject of the internal market for natural gas[1]. This included a proposal for a Council Directive on gas transit which, with certain amendments, has now been the subject of a favourable common position in the Council of Ministers[2].

2. The Gas Transit Directive would apply only to transactions which involved cross-frontier trade within the Community, and which were conducted by the companies owning the Community's high pressure transmission grids. It would not therefore assure third party access for others such as gas producers or other suppliers, non-integrated gas companies or particular types of consumer.

3. In its September 1989 Communication the Commission announced its intention to hold a dialogue with interested parties before deciding whether or not to make further proposals on third party access. This would be achieved by creating two Consultative Committees, one composed of Member States' representatives and the other of representatives of producers, gas companies and consumers.

4. The second of these Committees, the Professional Consultative Committee for Gas (PCCG), met for the first time on 18 May 1990 and has been responsible for the preparation of this Report. The full membership of PCCG is set out on page (..), together with a note on the procedures followed in preparing the report.

5. The terms of reference agreed by the Committee at its first meeting were:

   'To identify and present the main technical, economic and administrative considerations which should be taken into account in Community policy on whether and, if so, in what form and by what means third party access to gas transport systems should be provided.'

   The Committee was not asked by the Commission to make specific recommendations on whether or not Third Party Access should be

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(1) COM(89)334 final of 6 September 1989

(2) In adopting that position the Council noted that strong opposition existed within it to adopting the so-called 'common carrier' rule.

introduced in the Community's gas transport system. This will be a matter on which the Commission will make its proposals following this Report and other consultations. Nor was the Committee asked to take a position on legal issues.

6. The following chapters of this Report describe the considerations which PCCG has identified in accordance with these terms of reference. On some key issues there were disagreements between members of the Committee, which are recorded in the Report.

7. In its first meeting the Committee underlined the difference between a common carrier and a third party access regime. The former concept would include the allocation of transport capacity pro-rata amongst all users at any given time, with no distinction between existing and new clients. This would obviously undermine, ab initio, the security of supply of existing customers and existing contracts. The common carrier approach is not therefore considered further in this Report.

8. It was also recognised that a number of types of third party access regime were possible, depending on which categories of consumers or other buyers, and which categories of suppliers or producers, were assured access rights. Rather than limit their scope, however, the consultations did not rule out any particular type of TPA client at this stage. The considerations identified in the Report would then assist the Commission to take a view on the merits of assuring access for particular types of client, as well as on the overall advantages and disadvantages of the third party access concept.

9. Similarly, to avoid limiting the discussion, the Committee was not invited to analyse future gas supply and demand prospects, or to assume that any particular energy policy objectives would apply. The 1995 Community energy objectives were under review. Some members felt that it was unsatisfactory to discuss the implications of TPA in the absence of a defined context or stated goals. In any case it was agreed that the Committee's discussions of the impact of TPA should take account of different possible gas supply/demand scenarios, and consider the effect of TPA on the Community's future pattern of energy use.

10. Lastly, it was agreed at the beginning of the Committee's work that it would be necessary to evaluate the effects of introducing third party access to both gas transmission and local distribution systems. Offshore pipelines were excluded from the scope of the Committee's discussions.

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Chapter 2

EFFECTS ON CONSUMPTION, PRICING AND COMPETITION

Security of Supply[1]

1. The security of supply impact on consumers who take advantage of Third Party Access (TPA) rights will depend on whether their new supplier has a diversified slate of gas sources or access to back-up deliveries. In fact TPA would enable a risk/reward calculation by the consumer - either individually or as part of a group. The potential risks - principally security of supply, would have to be balanced against the potential rewards - principally a wider opportunity to seek lower cost gas supplies. This approach would give consumers with TPA rights greater choice than they presently enjoy and clarify the costs for them of different options.

2. A TPA regime might grant access rights to all consumers or only to certain types of consumer. But in any case it would not oblige eligible purchasers to take advantage of those rights. Even given the ability to engage in direct purchase, large numbers of consumers might choose to retain their present level of security rather than participate in such arrangements. But their potential recourse to TPA should still result in a more competitive environment.

3. The degree of security enjoyed by an individual consumer will depend on the flexibility provided by his gas supplier, on his ability (if any) to switch to an alternative fuel; and, in a TPA situation, on his ability to switch to an alternative source of gas supply. The fact that European supply is dependent on a limited number of sources would constrain flexibility on the last point.

4. The group best equipped to engage in direct purchase are on the one hand electricity companies and on the other hand industrial consumers with interruptible capability (i.e. ability to switch to an alternative fuel at short notice and for an indefinite period of time) or, more rarely, with on-site storage capacity. Such customers using transportation services would have few security of supply concerns. To the extent that the introduction of TPA encouraged existing gas consumers (or third parties) to install additional dual-fired facilities and storage, this could improve the total security of supply situation. The scope for

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(1) This section of the report deals only with security of supply at the level of the individual consumer. The possible effects on TPA on overall Community gas supply are discussed in chapter 4.

customers switching to interruptible supply would depend on existing gas supply contracts and infrastructure. Those opting for interruptible supply would, of course, have to be prepared to interrupt when required, rather than rely on political pressures in their favour in a crisis situation.

5. Firm industrial consumers (with more limited fuel switching options or using gas as feedstock) engaging in direct purchase would be exposed to a degree of risk that their, possibly less diversified, TPA supplier might be unable to meet their peak supply requirements, and that in a worst case situation their source of supply might be curtailed or cut off completely. In such cases, these consumers would need to seek gas elsewhere, probably from their 'local' or traditional suppliers. There is a major issue of dissent as to whether, under TPA, traditional suppliers should have any obligation to supply gas in such cases. Replacement supply may not always be possible if there are limitations on gas supply or delivery capacity at the time the supply is needed, particularly since the merchant suppliers will give first priority to their own customers. A distinction should therefore be made between providing a replacement supply if the necessary gas and pipeline capacity are available (Back-up) and a guarantee of replacement supply (Stand-by). Replacement supplies, when necessary, would probably need to be the subject of a separate contract with the traditional supplier as an 'unbundled' service. A stand-by contract guaranteeing supply would need to take account of the costs of the necessary reserve gas production (or storage) and transport capacity. These questions of replacement supply would probably have to be covered by the regulation accompanying a TPA regime (chapter 5).

6. There is also the issue of whether a customer who decided to bring to an end a TPA contract would be able to revert to his traditional supplier. To the extent that the latter remained in a dominant position in the gas market, it might be necessary to apply a 'non-discrimination' rule to ensure that the returning customer was treated no differently than an altogether new customer (see chapter 5).

7. Consumers without fuel-switching options - particularly residential and commercial customers - are in a more vulnerable security of supply position. While small consumers will probably be less likely to experience direct benefits from a system of TPA than large industrial users, there is no reason to automatically conclude that there will be no benefits for small consumers. Possible developments could include groups of consumers engaging in direct purchase, or LDC's doing so on behalf of all their customers (see below). Some Committee members agreed however that smaller consumers might be worse off under a TPA regime.

8. The fact that security of supply issues are most acute for small (principally residential and commercial) consumers, for whom the risk of interruption is most significant, raises an important issue. It might be judged that allowing household consumers or groups of such customers to engage in TPA would expose them to unacceptable security of supply risks, unless they have an alternative fuel supply, and possibly also to safety risks at times of supply interruption. Such a decision would create at least two groups of consumers: those eligible to engage in TPA and those which were not, with the latter presumably retaining their regulatory protection in terms of pricing and supply security. This type of approach would, however, carry with it a risk of discrimination, denying freedom of choice and direct or indirect TPA benefits to a whole category of consumers. One possibility would be to increase the number of categories of consumer eligible for TPA over time, as the market situation developed.

9. As a system of TPA evolved, LDCs might themselves opt to participate in direct purchase, even if this meant that they had to enter into some degree of offtake commitments. This development could present advantages in terms of the purchasing power LDCs could exert on behalf of their customers by having the possibility of buying gas from a range of gas companies and producers, but it could also present problems in that LDCs tend to serve customers who could not accept significant reductions in security of supply and who might, as discussed above, benefit from supply obligations. LDCs buying from other sources might have less flexibility than the gas companies in terms of gas portfolios and purchase contract duration, and thus not be in a position to provide the same level of security. LDCs exploiting TPA rights might however be able to balance these risks by diversifying their range of supply contracts, including longer-term contracts, by investing in storage capacity or other contingency measures, and by selling more interruptible gas. Regional LDCs (or consortia LDCs) would clearly be better placed to do this than local or municipal LDCs operating mainly in the residential market.

10. Because of the relatively secure position of larger industrial customers with dual-firing facilities, a TPA regime could have an incentive effect on interruptible gas sales. The extent to which additional gas could be made available on this basis in the shorter term would depend on the flexibility remaining in existing production capacity, gas purchase contracts and pipeline delivery capacity. The merchant gas industry's view is that this flexibility is at present limited although this could improve as the new market situation evolved. From the point of view of the gas industry, interruptible contracts are at present designed to allow gas companies to use gas released by such customers to meet peak demand, mainly in the residential market.

11. Overall, it is evident that a TPA regime would lead to important changes in the security of supply situation for natural gas, but it is less clear whether those changes would be beneficial or undesirable. The current assumptions on security of supply needs would not necessarily survive. In the view of some Committee Members TPA could create a market for security of supply where its value would be determined by market forces. New and more flexible approaches could evolve from the greater role consumers would have in determining their own security of supply arrangements. In some cases very large consumers might even be able to provide their suppliers with greater overall flexibility, particularly if they could 'onsell' surplus gas to others. Some customers might also invest in their own security arrangements on the basis of savings in gas costs. Storage facilities would probably be too expensive for most companies to contemplate, although Third Parties might offer these or other back-up facilities. Dual-firing would probably increase. Finally, according to this view, a more competitive market should bring more suppliers into the market and give greater scope for the price mechanism to bring supply into line with demand when tight market situations develop.

12. The counter-argument is that the present integrated system should produce greater rationalisation of security arrangements at lower costs. By aggregating the demand of a greater number of customers, including LDCs, the gas companies should be in a better position to purchase diversified supplies, to take advantage of scale economies in investing in storage and reserve pipeline capacity, and to provide their customers with a high level of security.

Quality of Service

13. It is important to note that customers using the low calorific value (L) gas networks, supplied mainly from the Groningen gas field, could be limited in their ability to exploit TPA rights. In certain countries and regions L gas accounts for a significant percentage of total demand. Some existing L gas consumers might however consider switching to high calorific value (H) gas by modifying their combustion equipment, although this would involve costs and would only be possible if the customer could be connected to a pipeline carrying the higher quality.

14. TPA may affect the quality of services which gas companies presently provide to distributors or to their own customers in terms of their ability to ensure gas quality, balance loads and offer short term contracts with zero or limited offtake obligations, whilst themselves purchasing long term bulk supplies under take-or-pay commitments (transformation of terms).

However, some consumers consider that the potential for increased choice is a more important determinant.

Pricing

15. The first major element under this heading is the likely effect of TPA on producer prices, whether purchases are made by gas companies or directly by consumers. Prevailing market conditions will be an extremely important factor. To the extent that the market is tight, the negotiating position of buyers will be weaker and this could increase the arguments for balancing the market power of producers against the integrated gas companies, rather than a potentially fragmented collection of consumers, always provided that the benefits are passed on. Even in a seller's market, higher upstream prices would presumably lead to some loss of market sales through competition with alternative fuels. Conversely if the market is in surplus, the position of consumers vis-à-vis producers will be stronger. And at any time there may be surplus gas available at the margin for direct sale. All this will depend on upstream considerations and the likely effect of TPA on exploration and production, which is discussed later in this report.

16. Many of the downstream actors in European gas industries - specifically gas companies and local distribution companies - enjoy a considerable degree of monopoly power or a 'dominant position' within their national and regional systems, subject only to competition from other fuels. TPA may introduce a change in the division of the profits from gas sales as between the margins earned by the producer, gas company and (where relevant) LDC, and the prices for gas (and other services) paid by the different groups of consumers. The experience of open access in the UK suggests it is possible for consumers to pay higher prices to producers than the gas company and still profit from direct purchase. But it is too early to draw conclusions about the medium to long term price consequences for UK consumers. The impact of TPA would evolve over time. As the market adjusted the opportunity for consumers to explore alternative purchasing options, whether or not they actually took up such options, would exert downward pressure on prices. This could be particularly important for industries committed without alternative to using gas as a raw material. A high degree of price transparency would be essential.

17. TPA would change the basis of the entire gas market. All consumers would be automatically affected by this change whether or not they chose to participate actively in TPA. There are conflicting views about the impact on particular types of consumer. Some argue that prices might rise and that in any case

large consumers would gain at the expense of small consumers because of their greater market leverage. Others believe that, the overall changes in price levels would be such that no consumers would be worse off than before, although some might gain more than others from the introduction of the new system.

18. There were also differences of opinion about the risks of cross-subsidisation between consumer groups. One view was that the introduction of TPA would help to expose any existing cross-subsidies because, under TPA, consumers would tend to pay for 'unbundled' services, with 'transparency' of pricing of those services. The other view was that TPA would increase the risk of cross-subsidisation. It would be important to ensure that those who could not engage in TPA did not find themselves paying a disproportionate part of the fixed costs of, particularly, the distribution systems. (These are issues to be discussed further under the heading of regulation in chapter 5.)

19. Under TPA prices could also be more affected by location. One effect of TPA competition could be to disadvantage TPA customers who were more distant from a source of gas supply. It is difficult to predict whether this relative disadvantage would be offset by an overall reduction in price levels, but if it were not gas penetration in such areas could be reduced. Conversely, TPA customers close to gas sources would presumably benefit.

20. Different <u>methods</u> of pricing gas to consumers have been adopted at different times in different countries. At present, a widely adopted practice in Europe is to price gas against (or just below) competitive fuels, usually oil. The advocates of this method suggest that it gives the highest possible market penetration for gas; is the most equitable for consumers; and is a flexible system able to cope with shifts in the prices of competing fuels. This view was not, however, shared by some other Committee Members.

21. However, under a TPA system where consumers had greater liberty to make individual deals, other pricing systems would emerge in negotiation, driven by gas-to-gas competition. Individual consumers could be expected to seek different pricing arrangements at different times and a variety of contractual arrangements could evolve. It is difficult to generalise about the types of price mechanism which might be favoured by consumers under TPA, but such competition would tend to bring final consumer prices closer to cost-related levels. Consumers would also have the advantage of no longer being faced with the risk of substantial short-term increases in gas prices when oil prices rose because of difficulties in the international oil market.

Energy and Environment Policy

22. The Community's energy objectives, adopted in 1986, call for the market share of natural gas to be at least maintained. These objectives are about to be reviewed and it is clear that the relative environmental advantages of gas are likely to favour its expanded use. The Energy Council has agreed in principle to the Commision's proposal that the 1975 Directive limiting the use of gas in power stations should be revoked.

23. Whether a TPA regime would accelerate the use of natural gas in the Community, which is already growing, will depend on whether the advocates of TPA are right in believing that prices would fall in the more competitive environment. Certainly gas penetration is much greater in the United States where competition is well established, although market conditions and industry structure differ in the two regions and TPA is clearly not the only factor at work. The extent to which additional supplies of gas could come forward would depend on whether TPA had a positive or adverse impact upstream (chapter 4).

24. Lower gas prices could, of course, act as a disincentive to energy efficiency, but it is not a sustainable argument that efficiency aims should be pursued by transferring economic rent from consumers to producers or suppliers. One other effect of TPA in this context could be to improve the economics of co-generation investments, which will also depend to an extent on developments in internal market policy in the electricity sector.

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Chapter 3

EFFECTS ON NATURAL GAS TRANSPORTATION AND RELATED SERVICES

1. Because of the degree of integration of transmission and distribution systems in most EC countries, this section of the report deals with gas transportation overall, including both the transmission and distribution functions. Reference is also made to some of the transportation-related services including: load balancing, back-up, storage, quality management.

2. It is important to distinguish between the transportation and merchant functions performed by many EC gas companies. While there is certainly scope for competition in the merchant function, this is less clear in the case of transportation. In practice gas transmission can be considered to be a near monopoly because of the financial, legal and institutional barriers to new pipeline construction. This can be even more true of local distribution, particularly in high population areas. The following paragraphs deal with transportation and related services, referring on occasion to issues arising from the integration of those functions and the merchant function.

3. It is however important to note that Eurogas and the integrated Community gas companies believe that there are strong inherent advantages in the integration of transportation and gas sales, from the point of view of both security of supply and the overall efficiency of the gas supply system. Others, including some consumers and LDC's argued, however, that the loss of any such advantages would be outweighed by the inherent benefits of increased competition as a consequence of TPA.

4. 'A Common Carriage' (pro rata transportation allocation) regime has the disadvantage that it would place at risk continuity of supply for existing gas users on the system. It is therefore assumed in what follows that any new access regime would adopt the concept of making spare capacity available, in principle, to third party users on some defined basis (see below). This is variously called 'open access' or 'third party access'. Since the former term would imply no distinction between the different types of consumer which might be granted access rights (see preceding chapter), the term 'third party access' (or TPA) is used in the remainder of this report without prejudging whether any particular types of consumers might or might not be granted such rights.

5. The key issues in the fields of transportation arising from a TPA regime would particularly be the availability and use of pipeline capacity (including investment in new capacity) and the charges for transportation and other services.

Availability and Allocation of Capacity and Related Services

6. Capacity is a complex concept which needs to be considered on a day-to-day, and in some cases an hour-to-hour, basis. Capacity cannot simply be considered in terms of space in a pipeline. Also, it may sometimes be necessary to consider the availability of related services such as gas storage and blending facilities.

7. One basic way of organising capacity allocation would be on a first come, first served system, although a number of modifications to this might be necessary to avoid operational difficulties or new obstacles to competition. For instance, if it was judged that an obligation to supply should be preserved for particular customers, such as the domestic and other small consumers who account for a major part of many EC markets, then a tranche of pipeline capacity would need to be set aside by the pipeline companies, or contracted by local distribution companies, to assure their security of supply. In that case, a TPA regime would only apply to part of the total capacity of the transport system. However, any contingency reserve or seasonal element in that 'set-aside' capacity could presumably be used for interruptible TPA sales, thus improving overall utilisation of the system.

8. There is also the question of contract duration. Capacity could be contracted on a long or a short term basis. Customers giving a high priority to security of supply would probably seek to enter into long-term contracts, those with greater flexibility might seek a less rigid contractual framework. Rules might need to be laid down on the relative priority to be given to such requests, as well as on other matters such as distance and interruptibility (see below).

9. To avoid unnecessary or deliberate reservation of unused pipeline capacity, it might be necessary to adopt the concept of 'use it or lose it'. This implies that in a first come first served system, capacity which remained unused over a defined period of time could be offered to the next customer waiting for service from the transportation company, either on a temporary or permanent basis.

10. Alternatively or additionally, TPA transmission contracts could be organised similarly to a property right which could - for a defined period of time - be acquired and transferred to other parties, provided that there were reasonably standard contract conditions (pressure, gas quality, contract duration , load factor). This could also have advantages for companies who might otherwise face an unacceptable risk in contracting capacity before they had finalised a gas purchase agreement. However, the location of the alternative customer relative to the original contractual commitment would be important, as well as various other operational factors. Gas companies could not be expected to transfer automatically a capacity commitment to serve alternative customers in entirely different locations, and it might not even be possible to do so in some cases. Local distribution companies should in most cases be able to provide some flexibility for the transport stage between the high pressure system and the alternative customer.

11. Other issues would arise under the heading of capacity allocation, for instance the risk that a TPA commitment to carry gas over a relatively short distance within a pipeline system could block longer transmission paths. Issues of this type would also need to be allowed for in the framework for a TPA regime.

12. Lastly, under the heading of capacity allocation, it is important to keep in mind that firm transportation commitments, whether arising from supply obligations or longer term TPA contracts, might still leave room for interruptible TPA contracts at times of lower demand (see also paragraph 7 above). Part of the gas industry believes however that this option might at present be limited by a lack of spare gas production and delivery capacity, as well as the need to use the summer period for maintenance and refilling gas storage. In the longer term the new market opportunities under a TPA regime might lead investors in gas production and delivery systems to provide for a larger capacity margin. This view is not however shared by the merchant gas companies.

13. In deciding whether to offer transportation services a gas company would clearly have to assess whether such an arrangement would infringe on the margin of spare capacity required to deal with emergency situations, as well as to cater for variations in the needs of its own contractual customers, or other pre-existing TPA contracts. It is however inevitable that disputes would arise when requests for TPA were refused on capacity grounds, particularly perhaps when the transmission network was owned by an integrated merchant company competing to supply the same market, rather than by a gas transportation company concerned to maximise the use of its capacity. Such disputes would need to be submitted to

arbitration by a regulatory authority or independent expert although, given the complexity of the subject, the judgements would not be easy and there would be difficulty in matching the expertise of the system owner. Decisions taken in this way, would need to have regard to existing contractual or legal supply obligations. This problem is considered further in chapter 5.

14. Another and more controversial option for a TPA regime would be to impose an obligation on the company owning the transportation network to ensure, given enough notice, that sufficient pipeline capacity was available to meet any TPA requests, by investing in new pipelines or by providing for more capacity in pipelines already planned. (This would always be subject to the necessary construction and wayleave consents being obtained.) For investment security it would be essential that firm long-term commitments should be made by the TPA customers, and that the investment costs could be recovered from transportation charges with a reasonable rate of return, taking account of business risks. Nevertheless, even under these conditions, the merchant gas companies would regard any such measure as unacceptable.

15. It would in any case be consistent with the introduction of more competition into the gas sector that any national rules preventing the construction of pipelines by new entrants should be removed. But, given the advantages of rationalising the overall system, and the fact that the present dominant position in transport of the existing integrated gas companies would certainly continue for some time, this liberalisation would probably not eliminate any need to require the existing companies to construct new capacity.

16. In a wider sense, there is concern on the part of the integrated gas companies that a TPA regime would undermine investment confidence, both in the case of large-scale pipeline projects bringing gas into the Community, and in the case of new pipelines within the Community. Theoretically if charges were set at a fair level, TPA contracts should not reduce revenues earned by a pipeline investment and might even increase them. But financing is at present often based on assessing revenues from both transport and sale. In some circumstances, therefore, particularly where investments had not yet been amortised, TPA could cause problems for pipeline owners unless there were suitable safeguards. Otherwise, in facilities where volumes were still building to plateau level, owners would run the risk that part of the initially unused capacity could be preempted by others, thereby preventing related contractual gas supply commitments from being fulfilled. These problems would exist in the case of both the 'immature' gas transportation systems under construction in some Community countries, and for major new investments in existing gas systems. The use of transportation capacity by third parties

might also prevent the gas company from fulfilling take or pay commitments upstream, or from supplying contracted future customers downstream. The merchant gas companies are concerned that these TPA-induced problems of fulfilling 'take or pay' commitments could cause them significant financial hardship or, at the extreme, bankruptcy. This potential problem would also need to be addressed in any future TPA regime.

Charges for Transportation and Other Services

17. Charges for pipeline transportation could be negotiated individually by the parties or determined on a cost-related basis. Since transportation would in most cases remain largely a monopoly service, the latter approach would seem more justifiable and less likely to give rise to economic distortions. However, the integrated gas companies and some other Committee members believe that a cost-related system would probably be less satisfactory. Another approach might be negotiation between the parties on the basis of cost guidelines laid down in advance, if necessary followed by a conciliation procedure. In general, discrimination between customers should be avoided. A related question is whether any distinction should be made between charges for the use of existing capacity and those for new lines, which would lead to a form of 'vintage pricing' (see also paragraph 19).

18. In economic terms, marginal cost pricing might be considered to send more accurate price signals to consumers. However this carries the risk of generating excessive profits or losses for the gas company depending on the relationship of the charges arising with the average system cost. For this reason, the use of average cost as the guiding concept seems to be more generally acceptable, although this would be a fairly complex process. The size of the pipeline, load factor, location of the consumer within the network, transport distance, contract duration and the impact on the overall system are all factors which should be taken into consideration.

19. With respect to the accounting basis for the derivation of charges, historic costs reflect the original capital investment required for the construction of the facilities, while current (replacement) costs reflect the present value of the system. The choice between these options will be important both for transport costs and for new investments.

20. In order to ensure that charges are fair, greater cost transparency will be needed. Equitable allocation of the unbundled costs of transportation as well as other services (load

balancing, storage and other induced costs), plus some allowance for risk, is a complex process. Integrated companies tend to feel that any such calculations would be misleading, whereas potential TPA users feel that unbundling of costs would be an essential requirement for such a regime. There could therefore be difficulties in persuading different parties to accept the derivation of costs which were intended to reflect the value of the services which they provided or received. Some of these services could be attributed to the merchant function rather than the transportation function. This complexity is increased because of different depreciation and taxation regimes in different countries. One way to reduce the scale of this problem would be to set upper and lower limits on transportation and related charges within which negotiations could take place.

21. It is possible that transportation unit costs could increase as a result of loss of economies of scale enjoyed by more integrated gas companies. Conversely, such increases might be offset by higher utilisation of the inland gas transport system.

22. To the extent that parties were unable to reach agreement by negotiation, there would be a role for regulatory oversight and arbitration in the allocation of capacity, investments, and formulating and overseeing transportation charges, including appropriate rates of return. Although these issues are further discussed in chapter 5, it is worth noting here that the extent to which transportation services are unbundled and separately charged would be an important determinant of the complexity of regulation.

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Chapter 4

EXPLORATION, PRODUCTION AND PURCHASE

The Effect of TPA on Exploration and the Development of New Fields

1. Companies involved in exploration and production in the Community point out substantial differences in market flexibility between natural gas and oil, to the disadvantage of natural gas and, particularly for offshore fields, differences in transport costs, the need in some cases for a dedicated transport system, lead times, and requirement to commit large 'front-end' investments. For these reasons producers, and the financial institutions which provide their backing, seek long term contracts with a high degree of offtake guarantee through take or pay commitment. Producers believe that the introduction of TPA would impact adversely on the ability to obtain such contracts, and, therefore, that they would be unable to develop major new fields requiring very large investments. For similar reasons many producers also argue that the incentive to explore for new gas would be reduced.

2. The majority of producers believe, therefore, that their requirements are best served by sales to companies which can provide long term financial and offtake commitments, and handle variations in production. By aggregating sales to a multiplicity of customers across different market sectors the major gas companies fulfill this role. Producers fear that the fragmentation of the customer base of the gas companies resulting from a TPA regime could undermine the latter's ability to sign long term contracts, and that the alternative of seeking long term take or pay contracts directly with consumers would not be feasible. Individual customers might not be willing or able to give such long-term guarantees of offtake, and in any case many such contracts would be necessary to reach a satisfactory volume. There would also be some degree of risk arising from the possibility of customers going out of business during the period of the contract .

3. The question is whether the current relatively exclusive producer-gas company relationships, involving long-term offtake commitments and netback prices maximised to a level determined by the competing fuel, are the only viable way of operating European gas markets. Some large gas users have shown themselves to be willing and able to sign long term contracts with take or pay commitments or offer other ways of risk sharing. Consortia of purchasers might

develop similar abilities. A TPA regime might also enable a buyer to 'onsell' gas that he had committed himself to take but no longer needed for his own plant, thus making it easier for buyers to provide offtake guarantees.

4. Producers would still be free under a TPA regime to sell to the existing gas companies, which would certainly remain major actors in the market. Both they and local distribution companies should presumably be able to provide some level and duration of offtake guarantees, particularly in an expanding market. In addition, if they had to assume more market risks, producers would at the same time have the advantage of being able to sell their gas in a much wider and growing (perhaps faster growing) market and to a variety of buyers, rather than just to the existing gas transmission companies

5. This last argument underlies the view that a TPA regime, and the consequent ability to sell to a wider range of buyers (including new market entrants) or direct to consumers, could have a positive effect on the level of gas exploration and production in the Community. This was one of the arguments made in favour of liberalisation of the UK gas regime. But, although exploration activity in gas areas of the UK North Sea has increased in recent years, producers argue that this has been due to other factors, and that there is no evidence that the changes in the UK regime had a positive or negative effect on North Sea gas exploration and development. Gas producers in the UK have not in any case been able to sell to markets outside that country.

6. Uncertainty about the effect of TPA on investment is particularly (although not only) relevant in the case of the development of very large offshore or remote fields, which can have an annual plateau production as high as 20 billion cubic metres (2 billion cubic feet per day), with capital costs of $5-10bn. The current planning is that developments of this type will be needed to meet future EC gas demand. Clearly producers involved in large projects value highly the financial security which is contained in the commitment of the gas companies. They are not convinced that the same degree of security for such developments could be provided by a situation where there might be wider opportunities for direct sales, but less scope for the gas companies to guarantee their offtake levels.

7. There were differences of opinion on whether a TPA regime might help or hinder the development of smaller gas fields. But in any case it seems unlikely that changes in the pattern of gasfield development induced by a TPA regime would bring forward enough lower cost gas to cater for future Community demand without the need for significant investments in major fields. It remains a key question, therefore, whether the industry is right in believing that investments in such fields would be deterred by a

TPA regime, or whether they would still take place, perhaps with a different phasing or different contractual arrangements, in response to growing demand and a wider but less guaranteed market potential. Much would depend on the relative competitiveness of these fields in terms of unit production and delivery costs.

The Effect of TPA on Existing Gas Production

8. The producers and merchant gas companies on the Committee pointed out that TPA could reduce the ability of buyers to honour their contractual commitments in respect of existing gas production. But, if introduced, TPA could possibly be applied to additional production from existing fields. For instance, spare capacity in production and delivery systems could be utilised to sell gas in excess of contractual commitments, although the industry believes that this option would be constrained by limits on field and pipeline capacity, which usually reflect supply contracts. Certainly the scope would vary seasonally, but interruptible sales should often be feasible. There might also be cases where delivery capacity could be upgraded without incurring prohibitive costs. For fields not sold on full-life depletion contracts it would also be less difficult to introduce TPA once the initial term of the contract had expired and different contractual terms could be negotiated.

Commercial Situation of Producers vis-à-vis Buyers

9. It is uncertain, whether, in itself, TPA would make any difference to the commercial balance of advantage between producers and existing or new purchasers. As important will be judgements as to : whether market (supply/demand) conditions favour buyers or sellers; the costs associated with gas development in new producing regions; and the degree and diversity of excess gas deliverability. As far as the direct effect of TPA is concerned, there are differences of opinion as to whether gas prices would be driven down by the introduction of gas to gas competition, or bid up because of the fragmentation of buyers in the face of a powerful group of producers and exporters, although in the latter case prices would presumably still be limited in the longer term by the risk of losing sales to alternative fuels in the different market sectors.

10. Nor is there agreement as to how TPA might change trends in gas demand. One view was that, unless oil prices fell considerably, a decoupling of gas prices from oil induced by TPA competition would allow gas to capture a greater market share and increase

volume sales. This would in turn be a constraint on future oil price escalation. Decoupling might also improve flexibility and security by encouraging the installation of more dual firing equipment. An alternative view however was that TPA would not lead to greater substitution of oil by gas because lower prices would not be sufficient to bring forward new gas from large, high cost grass-roots projects.

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Chapter 5

REGULATION AND MODALITIES

1. There is consensus that, if some form of TPA regime were to be introduced, care should be taken to ensure that the associated regulatory procedures should not be (or become) too lengthy, complex and costly, involving the creation of large regulatory authorities. In addition, it would be necessary to guard against procedures designed to regulate a relatively limited part of the industry 'creeping' into other areas, thus expanding regulatory jurisdiction. However, some Committee members felt that it would not be feasible to limit the amount of regulation in a TPA situation and that regulation would tend to increase over time

2. As well as the control over the gas market and over the use of gas transmission networks exercised by the industry itself, there is already a degree of regulation of the gas industry by national authorities, at armslength or through State ownership. The situation varies from one Member State to another but the most widespread regulatory activities which are relevant to this report concern consumer prices and obligations to supply.

3. For consumers who did not enter into a TPA regime, existing regulations of this type would probably continue. But for TPA customers both gas prices and the degree of supply security could be left to negotiation between buyer and seller. Regulatory authorities would however need to look at the allocation of costs over the whole system (as is already the practice in some countries) to ensure that there was no cross-subsidisation between different classes of consumer. The introduction of TPA would be likely to focus more attention on this issue, particularly since it would tend to discourage the practice of pricing gas in relation to other fuels (see chapter 2). The allocation of costs to different classes of consumer would be a complex area of regulatory activity, although this should be helped by the greater transparency likely to be brought about by TPA competition. In time, the introduction of TPA would probably also change the present structure of gas purchase contracts, where price formulae tend to be based on a weighted average of the prices obtainable from different types of consumer.

Gas Transport

4. A TPA regime would create a need for new types of regulation in the field of gas transport (transmission and distribution) to ensure that the objective of opening the market to competition was achieved. Although it would be a logical counterpart of such a system to remove any remaining barriers to pipeline construction by other companies, gas transportation would tend to remain a near monopoly activity - at least for some years ahead.

5. The aim therefore would be to devise a practical, effective and reasonably simple approach to satisfying this need for regulation. One way of minimising detailed case-by-case regulation could be for the key principles to be laid down in a legally binding Community instrument as a basis for the introduction of TPA. This would probably have to cover:

- which classes of consumers, distributors and other suppliers (e.g. brokers) would be eligible for access to transportation and related services. There could be three categories of eligibility :

  - those declared to be eligible for TPA;
  - those who could choose to be eligible but who would otherwise remain covered by existing regulatory arrangements;
  - those declared ineligible, at least initially.

- gas quality and quality of service standards,

- principles for allocating capacity in the event of demands for transport exceeding the spare capacity available. These could be based on 'first come first served' and 'use or lose it' rules, but might need to take account of other factors e.g. contract duration, distance or interruptibility.

- non-discrimination rules, for instance between returning and new customers.

- transparency of information on present and future transport capacity;

- possibly, an obligation on the owners of transport systems to maintain a sufficient level of capacity over time to provide for their own customers, TPA contracts and a defined contingency reserve;

- principles for determining charges for transport and for any related services covered by the TPA system, including cost transparency and allocation;

- a requirement to publish and keep up-to-date a scale of charges for transportation and related services;

- arrangements for back-up supply in emergencies;

- commercial confidentiality;

- any non-contractual procedures for settling disputes before recourse to the regulator.

The legal instrument might also usefully include statements of principle on the treatment of non-TPA consumers in terms of security of supply (supply obligations) and avoidance of cross-subsidisation.

6. These Community principles should clearly be drawn up after consultations between the regulatory authorities, the gas industry and gas consumers. Once the principles were established, the regulatory authorities would not be called upon to intervene unless the commercial parties concerned could not reach agreement within the principles, or one or both parties felt that the principles were not being followed.

7. The extent to which this approach would be successful in minimising day-to-day regulation and avoiding recourse to the Courts if a TPA regime was introduced, would depend on whether all sides felt that the basic principles were practical, comprehensive and fair, and on the willingness of the industry to make any such regime work. There would inevitably be some disputes initially, but these should become progressively less common as the basic principles were tested and upheld.

8. The scope for disputes could possibly be reduced by a degree of industry self-regulation, or arbitration by joint groups of industry and consumers as already exists in some cases. These options, which would still leave open the possibility of recourse to the regulator if self-regulation did not succeed, should be taken into account in deciding on the type of regulation necessary.

9. It is important to record that the merchant gas companies and others on the Committee did not believe that the approach outlined in paragraphs 5 to 8 above would be fair, practicable or successful in reducing the need for detailed regulation.

10. A regulatory system for TPA should be concerned with safeguarding the position of all those involved in the transport system, including the gas companies themselves. Account would need to be taken of contractual commitments, particularly take or pay contracts, which could, if not fulfilled in consequence of a TPA regime lead to major claims for compensation against merchant gas companies unless acceptable solutions were found. Transitional arrangements might be needed to deal with this type of problem.

11. On transport capacity there would have to be an equitable system, capable of dealing with the complex EC pipeline network, for identifying and allocating spare pipeline capacity where this was insufficient to deal with all new transmission needs, and for ensuring that capacity could still be made available to deal with emergency situations. There might also be a need to ensure that the development of gas pipeline networks over time took account of TPA as well as of the merchant companies' own sales.

12. The principles for setting transport charges and charges for other services would be particularly important as a key factor in establishing competition and in the gas companies' financial viability. The principles would need to provide for reasonable rates of return on capital investment. Cost transparency and separate accounting for transport would be essential, for instance to ensure that there was no discrimination between transport charges for TPA users and that element in the prices paid by the gas companies' own customers. Transparency would also, by providing comparative data, help to identify 'gold plating' or other cases where unnecessarily high costs had been incurred in new investments.

13. For a 'user-friendly' TPA system it would probably be necessary to require system owners to publish a standardised scale of transport charges, based on a few variables such as distance, throughout, maximum capacity, interruptibility and possibly contract duration. An element of negotiating flexibility could be preserved by quoting the scale of charges in terms of maxima or ranges. Given the difficulty of precise cost allocation in a complex system, this approach would clearly involve approximations. But, if the basic principles were satisfactory, it should not lead to any unacceptable market distortions or financial risks.

14 The merchant gas companies and others argued however that the type of cost-related approach outlined in paragraph 12 would not be feasible, and that a simplified scale of transport charges would be arbitrary and likely to lead to market distortions.

15. The most practical method of applying the type of regulatory mechanism described above might be to vest the necessary powers in national authorities. But a degree of Community-level involvement, either through the Commission or a new body, would certainly be necessary to ensure that national regimes operated on the basis of harmonised principles, and to deal with disputes arising from cross-frontier TPA activity.

16. The possibility of legislation based on the prevention of abuse was also suggested and is mentioned in paragraph 19 of the Executive Summary.

17. Under a Community-wide TPA regime competition could be distorted by differences in national conditions, for instance in taxation levels, depreciation rates or environment/safety standards. Some of these differences might be 'driven out' by the consequences of market competition, but in other cases Community-level negotiations to agree on common rules might be necessary.

18. There are differences of opinion as to whether other services associated with gas transport should be subject to TPA, and hence to regulation. The most important issue here is storage but blending and control of gas quality are also relevant. In some countries, storage facilities are extremely difficult to build (because of a lack of available underground structures, safety rules, or difficulty in obtaining permission for sites); in others, the position is less difficult and storage may not be considered as a hurdle to market entry. In some countries individual customers own storage facilities; in others, all storage is owned by the gas company. In a TPA system, there could be a separate market in storage capacity, as well as a market in pipeline capacity.

19. Lastly, although not strictly under the heading of TPA, there could be a case, particularly if TPA were introduced, for lifting other barriers to competition and market entry such as import/export restrictions, or statutory purchase or sales monopolies, as well as liberalising the construction of gas pipelines and storage facilities.

* * * * * *

Glossary of terms

Access rights	Right to the use of the transportation grid in a TPA system.
Back-up	To supply a TPA user if gas and pipeline capacity are available, when the user's normal source of supply is temporarily interrupted.
Broker/Trader	An intermediary who buys gas from whatever source for its subsequent resale.
Common carriage	Theoretical definition of common carriage includes the allocation of capacity pro rata among all applicants. This concept is excluded in the definition of TPA used in this report.
Cross subsidisation	Process of charging an unjustifiably low price to customer groups and compensating for this by charging higher prices to other customer groups.
Distribution	The transport of natural gas on lower pressure local networks for delivery to final consumers.
Downstream	Gas operations relating to transmission within the European Community, distribution and related services as well as gas marketing.
Integrated gas company	As merchant gas company, but also performs the function of distribution.
LDC	Local distribution company.
Merchant gas company	Gas company that includes the following functions: bulk purchase from producers and wholesalers, transmission and sale of gas.

Region	The geographical area served by a particular grid.
Stand-by	To guarantee in advance supply to a TPA user at any time his usual source of supply is interrupted.
Supply	The delivery of natural gas to final consumers including necessary arrangements for purchase, transport, storage, and other related activities.
Take or Pay Obligations	Financial contractual obligation of a natural gas buyer to pay for a certain minimum quantity of gas irrespective of whether he takes delivery of that gas.
Third Party Access - TPA	A scheme providing for a qualified obligation on companies operating natural gas transportation facilities to offer terms for the use of their system.
Transmission	The transport of natural gas on the interconnected high pressure grid.
Transport/transportation	Includes both the transmission and distribution functions.
Unbundling	Disaggregation of charging, accounting or management of particular operations, or even ownership of an integrated or partly integrated gas company.
Upstream	Gas operations relating to exploration, production and purification of natural gas up to the delivery point to the transmission grid in the European Community.

LIST OF BACK-UP PAPERS TRANSMITTED BY COMMITTEE MEMBERS
UP TO 2 APRIL 1991

LISTE DES DOCUMENTS TRANSMIS PAR LES MEMBRES DU COMITE
JUSQU'AU 2 AVRIL 1991

LISTE DER BIS ZUM 2 APRIL 1991
VON AUSSCHUSSMITGLIEDERN ÜBERMITTELTEN DOKUMENTE

1. **EUROGAS** 8 June 1990

   - Alternative Open Access Scenarios
     (distributed at the meeting of 13 June)

2. **EUROGAS** 12 June 1990

   - Energy objectives and criteria
     (distributed at the meeting of 13 June)

3. **EUROGAS** 28 June 1990

   - Working document regarding effects on consumption, prices and competition.

4. **EUROGAS** 3 July 1990

   - Open Access Security and Interruptibility.

5. **EUROGAS** 3 July 1990

   - Impact of Third Party Access on Transmission.

6. **B. BERGMANN** 3 July 1990

   - Paper from Verband Kommunaler Unternehmen.

7. **E&P FORUM** - Mr. G. Thorp - Letter 6 July 1990

   - Comments on PCCG(90)8 and PCCG(90)9
     (distributed at the meeting of 11 July)

8. **CEFIC** — 6 July 1990

   - Interruptibility - Gas storage
     (distributed at the meeting of 11 July)

9. **CEFIC**

   - PCCG - CEFIC briefing.
     Open Access for Gas - The Market
     (distributed at the meeting of 11 July)

10. **GAS CONSUMERS COUNCIL** — 13 July 1990

    - Comments to PCCG(90)9, paragraph 7.

11. **CEFIC** — 18 July 1990

    - Responses to the recommended revisions by E&P Forum.

12. **EURELECTRIC** — 23 July 1990

    - Comments on Summary minutes of the PCCG meeting of July 13.

13. **RUHRGAS** — 31 August 1990

    - Interruptible contracts

14. **EUROGAS** — 7 September 1990

    - Comments on the minutes of the PCCG meeting of 11 July 1990.

15. **CEFIC** — 12 September 1990

    - Environmental considerations.

16. **E&P FORUM** — 14 September 1990

    - Comments on PCCG 90(9) Rev and Position Paper on COM(89) 334.

17. **EUROGAS** — 12 September 1990 and 14 September 1990

- Comments on Chapter "Consumption, Pricing and Competition".

18. **EUROGAS**

- Study on Natural Gas on the Single European Market by the Institute of Energy Economics of Cologne University.

19. **P. HATRY** — 17 September 1990

- Views on TPA in connection with security of supply and energy policy.

20. **CEFIC** — 19 September 1990

- Comments on the draft text "Effects on consumption, pricing and competition" and response to Eurogas letter on interruptible contracts.

21. **EUROGAS** — 19 September 1990

- Impact on Third Party Access on Gas Transmission.

22. **DISTRIGAZ** — 19 September 1990

- Interruptible sales in Belgium.

23. **WINTERSHALL** — 19 September 1990

- Fax regarding discussion on consumption, pricing and competition.

24. **CEFIC** — 20 September 1990

- Comments on the draft text "Effects on consumption, pricing and competition".

25. **IFIEC Europe** — 26 September 1990

- Position of large industrial consumers.

26. CEFIC 15 October 1990

- Letter concerning Consumption and Competition.

27. CEFIC 19 October 1990

- Letter concerning Exploration, Production and Purchase.

28. CEFIC 19 October 1990

- Comments on PCCG(90)14

29. CEFIC 6 November 1990

- Letter concerning Exploration & Production

30. E&P FORUM 6 November 1990

- Representation on PCCG

31. DISTRIGAZ 7 November 1990

- Terms of reference

32. E&P FORUM 22 November 1990

- Comments on PCCG(90)17

33. PNEM 22 November 1990

- Gas regulation

34. RUHRGAS 26 November 1990

- Modalities and regulation (Jensen Ass. report)

35. EUROGAS 3 December 1990

- Comments on PCCG(90)17

36. **EUROGAS** 11 December 1990

- Comments on PCCG(90)14

37. **VEGIN** 13 December 1990

- Comments on PCCG(90)14Rev

38. **IFIEC** 16 December 1990

- US Gas market to-day

39. **CEFIC** 20 December 1990

- Exploration, production and purchase

40. **CEFIC** 21 December 1990

- Comments on PCCG(90)19: Regulation and modalities

41. **EUROGAS** 21 December 1990

- Exploration and Production

42. **CEFIC** 21 January 1991

- PCCG back-up papers

43. **COMITE CONSULTATIF DES CONSOMMATEURS** 21 Janvier 1991

- Lettre sur les travaux du PCCG (distribuée lors de la réunion du 21.1.1991)

44. **CEFIC** 22 January 1991

- Comments on PCCG(91)1 Draft 1 Final Report.

45. **E&P FORUM** 23 January 1991

- Comments on PCCG(91)1 Draft 1 Final Report.

46.	**EUROGAS** - Comments on PCCG(91)1 Draft 1 Final Report.	25 January 1991
47.	**EURELECTRIC - SEP** - Comments on PCCG(91)1 Draft 1 Final Report	25 January 1991
48.	**UNICE** - Finalisation report.	6 February 1991
49.	**WINTERSHALL** - The use of natural gas as a raw material	13 February 1991
50.	**EUROGAS** - Comments on PCCG(90)19: Regulation and modalities	14 February 1991
51.	**E&P FORUM** - Comments on PCCG(91) Draft 1 Final Report	14 February 1991
52.	**IFIEC** - UNICE's positions on TPA	14 February 1991
53.	**EURELECTRIC** - Comments on procedure followed	15 February 1991
54.	**PNEM (Mr. Wiechers)** - Comments PCCG(91)1	15 February 1991
55.	**GAS CONSUMERS COUNCIL (Mr. Powe)** - Amendment executive summary	15 February 1991

56. IFIEC (Mr. Plénard) 16 February 1991

- Comments on PCCG(91)1

57. E&P FORUM 21 February 1991

- Comments on PCCG(91)1

58. KRACHTWERKTUIGEN (Mr. van Hasselt) 22 February 1991

- Final report - comments made by Mr.Hatry

59. CEFIC (Mr. Wilson) 22 February 1991

- Comments on PCCG (91)1

60. PNEM (Mr. Wiechers) 22 February 1991

- Comments on PCCG(91)1

61. UNICE 25 February 1991

- Comments on Mr. Hatry's position

62. SEP (Mr. Ketting) 1 March 1991

- Comments on Dr. Budde's letter to Mr. C.L.Jones

63. Mr. Paul HATRY 4 March 1991

- Comments on Mr. Plenard's letter to Unice

64. EURELECTRIC (Mr. Ketting) 7 March 1991

- Comments on PCCG draf final report

65. EUROGAS (Mr. Claus) 18 March 1991

-Comments on Dow Europe's letter dd. 20.2.1991

66. ICI (Mr. Gavens) 21 March 1991

- Comments on PCCG Draft Final Report

A N N E X E S

Annex 1

CEFIC

CONSEIL EUROPEEN
DES FEDERATIONS
DE L'INDUSTRIE CHIMIQUE

LE DIRECTEUR GENERAL

Mr. Clive Jones
Deputy Director-General
Directorate General XVII
COMMISSION OF THE EUROPEAN
COMMUNITIES
Rue de la Loi, 200
1049 BRUXELLES

Bruxelles, 12 April 1991

Dear Mr. Jones,

ANNEX TO THE FINAL REPORT OF THE PCCG (PROFESSIONAL CONSULTATIVE COMMITTEE - GAS)

In the last PCCG Meeting on March 26, 1991, you announced that the EC Commission had agreed to the fact that individual Members of the Consultative Committee could express their own view on the effect of TPA in a separate Annex to be attached to the Final Report.

CEFIC - as an invited Member of the PCCG - is keen to take advantage of this opportunity to make its view known to the Commission.

The CEFIC Gas Spokesman and Suppleant have drafted the attached Position Statement - together with Members of the CEFIC Gas Working Party - which puts forward in a concise form the view of the gas consumers.

Naturally, as we have had to state before, not all CEFIC Member Companies - particularly the upstream oil and gas producers - are in agreement with the majority CEFIC position of support by the chemical industry gas consumers for open access to gas.

Yours sincerely,

H.H. LEVER

12 IV. 1991
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CEFIC ENERGY COMMITTEE

POSITION PAPER

ON

PROFESSIONAL CONSULTATIVE COMMITTEE ON GAS

PREFACE

The initial terms of reference proposed by the commission and adopted by the Delegates of the PCCG, required the Committee to assist the Commission in identifying and presenting the main technical, economic and administrative considerations to be taken into account in the Community policy with regard to TPA.

CEFIC contributed to PCCG debates in the belief that the end result would be a Committee Report based on the consensus achieved and recording the major points of disagreement.

CEFIC believes that the Committee Report is reasonably fair and CEFIC would have been content to see it published alone. The decision of certain members of the Committee to publish their views in full as an Annex Report has caused CEFIC to reluctantly replicate this action in order that the consumers view is fairly represented.

INTRODUCTION

The structure of the European gas market, in which supply is controlled by obligopolies and distribution in most cases by countrywide monopolies, has produced good results during the early years of the gas market development, but has failed to adapt to the differentiated consumers needs of today's increasingly competitive global market.

A small number of major companies have shareholding interests in gas production, gas transmission and gas distribution companies throughout Europe.

The situation is further complicated by such political issues as the desire to protect the indigenous coal industry in many countries and taxation on gas production as a major source of state revenue.

Given this structure it is not surprising that some gas production and distribution companies are slow to respond to the challenge presented by the introduction of competition; indeed it could be asked when has a monopoly welcomed the breaking up of its control on the market. Nevertheless the UK experience has shown that a TPA regime can operate successfully given a positive approach by market participants.

The result of the current market structure has been a slow growth in Europe of gas consumption; in fact the share of the primary energy sector which gas held in West Europe in 1989 was only 15.8%, whilst in USA was 24.5%. Another example,taken from the BP Review of World Gas August 90 issue, shows that the consumption in the EEC has grown from 199.7 BCM in 1979 to 214.8 BCM in 1989, an average growth rate of only 1,5% per annum. Greater penetration of gas in the energy market would have occurred with gas to gas competition, encouraged by gas prices below oil parity, in this period when oil prices were at times over 30$/bbl.

The consumers today are faced with the simple prospect of no supply alternative. Producers who have gas, but no shareholding in the transmission companies, have no practical means in the absence of TPA of getting gas to the market, and they have no other choice than to fit in with the current structure of selling gas to transmission and distribution companies.

So from a structural and commercial point of view the European gas market has massive potential but is stifled by ist very monopolistic nature.

THIRD PARTY ACCESS (TPA)

To change the gas market in Europe requires moves to break its monopolistic structure and encourage gas to gas competition. The introduction of a Community Directive allowing third party access is the first necessary step toward an integrated European energy market. It will allow to buyers and sellers of gas the right to be offered transport services - on a first come first served basis - where capacity is available. As a result any company having gas to sell will be free to do so to consumers with an interest in purchasing.

EFFECTS OF TPA

We will examine the effects of TPA on the main issues of:

- pricing, consumption and competition
- security of supply
- transportation
- exploration and production
- regulation

1. Pricing, Consumption and Competition

The introduction of TPA will have important economic implication; in fact by enabling gas to gas competition it will eventually result in a reduction of gas prices to all consumers.

The driving force for price reduction will come from more efficient utilisation of the gas grid and clear evidence is provided by the comparison between Europe and USA. In the latter, the utilisation rate for the 24 largest US pipelines was over 90% as compared with less than 50% for the national transmission systems in Europe (R. Hopper Report, pp 9 and 10). The small and large consumers will have a choice of supply and the ability to negotiate terms according to their needs. Today's pricing the gas at the alternate fuel price level ensures the consumer pays the maximum, discouraging gas consumption and reducing market penetration.

The alternative fuel philosophy in many cases discourages efficient use of gas. Why should a consumer who has invested in gas turbine combined heat and power facilities and therefore is only able to use gas oil (light fuel oil) as an alternative fuel be required to pay more for his gas then a consumer who uses gas less efficiently in a steam boiler / steam turbine facility but can use cheaper heavy fuel oil as an alternative fuel? CEFIC believes such anomalies can only be finally removed in a competitive market.

Large industrial gas consumers will of course invest in dual fuelling and gas storage to be able to negotiate interruptible contracts at lower prices.

The consumers will have to balance security of supply with price and may choose sometime to maximise the reliability at the expense of economic advantages.

The market developments of the last few years in the UK and USA indicates that it is the small to medium consumer who has benefited most, not the large industrial user. In the USA the household gas price index fell more than the same index for industrial consumer in the years from 1986 to 1989. In the UK competitors to British Gas have targeted small to medium firm gas users and some argue that the 25.000 therms per year limit - below which British Gas have monopoly rights of supply - should be reduced.

2. Security of Supply

The issue of security of supply can potentially apply to upstream and downstream segments of the production-transmission-distribution chain.

We refer to security of supply for upstream gas production investments and to reliability of supply for downstream gas transmission and distribution investments. The security of supply is dependent from the number of development projects being pursued by the exploration / production companies.

The growth in exploration in the UK overall and Southern Basin in particular since liberalisation of the gas market shows how TPA can encourage new supplies. The "secure" volume guarantees which the transmission companies supposedly provide today, are based on pricing the gas as high as possible and this hardly gives the production companies optimism to explore and secure new gas fields.

Existing contracts will not be necessarily affected by the TPA and those contracts that do expire would leave the producers happier in the security of higher demand and broad customer base securing their gas sale.

It is recognised however that transitional arrangements may be necessary in the introduction of TPA to take account of commitments already made by gas companies.

TPA will broaden the market to include large independent consumers or new aggregators of demand other than the gas companies.

In fact, today's dominant position of the 2 or 3 large gas distribution companies affects the producers to the extent that they need to secure long term supply contracts.

In the UK, the multitude of deals between producers and direct consumers and the commitment of producers like Statoil and BP to the newly created free market show the benefit of TPA on the security of supply.

As far as the downstream sector is concerned, the introduction of TPA will not have an adverse effect on the reliability of supply; indeed it can be argued that the end result will lead to improved reliability of the system as a whole.

In a TPA regime certain customers with a low need of reliability of supply will negotiate interruptible contracts and effectively enhance the safety margin currently inherent to the system, for the benefit of the remaining customers opting for more traditional secure supply contracts.

It is not envisaged that TPA would be anything but voluntary for participating players and so it is clear that purchasers would not be obliged to take advantage of such rights. Whilst the small commercial and residential consumers are in a less flexible position through having no realistic dual fuelling alternative, their security of supply will not be threatened. The local distribution companies (LDC) will take on a negotiating role on their behalf using their stronger bargaining position in a TPA environment.

A TPA regime will provide consumers with the opportunity to negotiate for the reliability of supply they need, thus ensuring that resources such as gas storage facilities and reserve pipeline capacity are allocated to those consumers who need a high level of supply security and are prepared to pay the cost. Such a regime also provides clear market signals for new investment in such facilities and encourages use of lower cost alternatives such as dual fuel flexibility when appropriate.

3. Transportation

In practice gas transmission can be considered to be a near monopoly today because of the financial and institutional barriers existing to new pipeline construction. TPA in itself does not affect this status quo, since it only advocates open access to any grid where capacity is available on a first come first served basis: a mechanism which protects existing captive customers. It is however highly desirable in a future free European gas market that anybody with substantial need and capital should be allowed to build pipelines across Europe. In a TPA regime on the other hand the unbundling of service of transportation from that of merchandising gas will tend to drive the business of gas transportation toward a more efficient use of the transportation assets employed. It will thus become in the transportation business interest to make available all spare capacity that does or can be made to exist with relatively inexpensive debottlenecking, for either firm or interruptible gas transportation.

It will of course be necessary to have a transparent market in order to verify the availability of spare capacity of transportation and to allow mediation in disputes where capacity has been declared unavailable. If a transmission company has in fact no available spare capacity, it will have the interest to declare the capital cost needed for incremental debottlenecking of the system. If capacity increases were already planned, then these should become of public knowledge so that interested parties can elect to subscribe to even larger capacity increases.

Interruptible transportation contracts will enable better capacity utilisation of the pipeline system while ensuring capacity is available when necessary to meet the needs of those consumers who require a secure source of supply.

TPA leads to more efficient use and operation of the existing transportation systems. As the European pipeline system moves to capacity so market forces will bring in new investment in pipeline and distribution. The announcement of the construction of the MIDAL Pipeline by Wintershall proves that TPA is supportive of these new initiatives. Finally the requirement of liberalisation of the European energy market - a goal of EEC for 1992 - is that national monopolies on the purchase / sale of gas from national fields should be eliminated. Privatisation of the local distribution companies should be encouraged and at the very least their performance separately identified and monitored.

4. Exploration, production and purchase

The situation of today with the maximum pricing system for gas (coupled to oil price) discourages the use and hence the exploration and production of new gas. In a TPA regime the market share of gas will increase vis a vis other energy sources and integrated or non - integrated energy companies will step in and provide the increase in production. The experience of the UK clearly shows that existing E & P companies will continue to explore for and sell gas and the existing transmission companies continue to buy the majority of gas on a long term committed basis. It also demonstrates that producers are prepared to market gas themselves directly to consumers and even to buy gas to support these market activities (Mobil purchase of Scott field gas).

A comparison of exploration in the decade of the 1980's in the North Sea Basin, UK Continental Shelf and US demonstrates the higher level of activity in USA and UK C Shelf where TPA was introduced. Reserves of gas convergent on the EEC are immense and will be developed when the need will be there. The cost of development will be least under a competitive environment. Flexible gas pricing brought about by gas to gas competition will ensure that large developments will be utilised at full rate from day one and hence improve the overall payback of the investments.

5. Regulation and Modalities

In comparing the new resources required for TPA regulation it will be recognised that already today there is a great deal of regulatory, monitoring and supervisory activity carried out by governments.

Upon introducing TPA regulation will be needed to guide the industry through areas of dispute/conflict. As TPA matures and players in the market accept self discipline then such regulations can be gradually withdrawn so that in the end the objective would be a self governing systems with a minimum of regulatory oversight.

The transmission and distribution systems are usually regarded as near monopolies and as such require strong regulation. In order to avoid a regulatory organisation stifling the gas market development, the regulation will have to be based on clear principles for the market players to implement and an effective means for settling any disputes, rather than a set of rules trying to foresee and regulate every possible event.

Under a competitive environment in which TPA exists and some national regulation like the one provided by OFGAS in the UK is introduced, the existing need for regulation of the monopoly supplier will be reduced. In fact the experience of the UK shows that a hand-off reactive approach with a minimum of regulatory oversight (2 man year) is working. The comparison often drawn with the larger staff of the FERC is misleading in that the majority of the staff is employed in activities related to deregulation.

The establishment of a European Arbitration Body will enable consumers, producers and transportation companies to have a forum where recourse will be possible in the event of disputes on application of the general regulatory principles, which have not been settled at the national level or involve transportation across national borders.

BENEFITS OF INTRODUCING TPA

The benefits of bringing gas competition to EEC are far reaching; we would like to examine in detail the:

- increased competitiveness of European industry
- overall economic benefits to the Community
- benefits on the environment

1. Competitiveness of the European Industry

The objective in the creation of the EEC was to provide a larger market place with consequent lower prices for consumers and/or improved quality of service. The improved competitiveness of the European chemical and other industrial Companies would lead to greater economic activity, prosperity and employment. For companies to be competitive an obvious essential requirement is that the procurement of essential services and raw materials like gas and energy is effected at globally competitive levels.

For energy intensive industries (like the chemical industry) the energy cost structure of today has a critical negative effect on their ability to compete long term with foreign companies either based in USA or in the Middle East. Eventually this will inevitably lead to a relocation of these industries to countries with lower energy costs with a loss of jobs and prosperity for the Community. The introduction of TPA will improve substantially this situation introducing important energy cost savings which will render these European companies competitive again.

2. Overall Economic Benefits

A study by R. Hopper, commissioned by CEFIC, to examine the potential economic benefits of TPA has concluded that the margin above gas acquisition cost being extracted today from European consumers is 7.8 billions ECUS/year higher than that in USA. The breakdown of this figure between household users and industry is respectively 6.2 and 1.6 billions ECUS/year, indicating that contrary to widely held perceptions, the household sector has more potential to gain from TPA than the industrial sector.

The adoption of TPA will result in a greater utilization of the internal and possibly external European gas transportation system, and an abandonment of rigid oil related pricing with consequent lowering of the general (i.e. for all customers) gas price level. The lower price of gas will be financed by the higher utilisation of the gas transportation/distribution system.

3. Environment Benefits

One of the most important global issues today is pollution and the effect industrial emissions have on the environment. The constraint the monopolies have exercised on increasing the gas share of the primary energy use has prevented Europe's exploitation of gas' environmental advantages over other fuels. The new technology of Combined Heat and Power (CHP) schemes using gas as energy source brings significant efficiency advantages over other fuels.

	Efficiency
Coal Fired	34%
New Coal Fired	37%
Gas Combined Cycle	47%
Gas Combined Heat & Power	80%

(from R.A. Evans ETSU for DOE 1990 - Environmental and Economic implications of small scale CHP)

Although some CHP schemes may be attractive even at gas pricing at oil parity, many schemes need, however, lower gas prices to be encouraged and a more flexible approach to gas price escalation (e.g. linked to electricity rather than oil prices).

The above report suggests it may be feasible to generate up to 50% of total electricity demand with CHP schemes and that 10% is realistic.

The UK market has shown that a competitive gas market enables more efficient ways of power production. Post TPA there are 27 projects at engineering, approval or feasibility stage using gas in CHP schemes which could displace some 25 million tonnes per annum of coal use.

The energy for a New Century document published in May 1990 by the Directorate General for Energy of EEC assesses consumption in year 2010 to reach 1376 millions tons of oil equivalents. If gas were to penetrate primary energy up to 25% and coal and oil giving up market share on a 2/3, 1/3 basis, the savings in pollutants would be a staggering:

72.000.000 tonnes/y of CO
490.000 tonnes/y of SOX
300.000 tonnes/y of NOX

In terms of LCP directive (Large Combustion Plant directive aimed at power stations) the savings detailed above, if coupled with energy efficiency savings brought about by more CHP projects, would contribute a 15% savings on SOX and 80% on NOX EEC target levels.

CONCLUSIONS

The 1992 single market objective is a major driving force to introduce competition to the European gas market and indeed the Internal Market will not be complete until energy (gas + electricity) are opened up to competition. The significant environmental benefits, the increase in competitiveness of the European industry and the overall huge economic benefits to the Community as a whole arising from the introduction of competition to the gas markets should be a major factor in the judgement of the Commission with respect to the introduction of third party assess.

COMITE CONSULTATIF GAZ

* Position des consommateurs sur le TPA *

La Commission des Communautés Européennes ayant affirmé que le marché de l'énergie étant un secteur comme les autres, les entraves aux échanges devaient être supprimées. Dans cette optique, elle s'interroge sur le fait de savoir si le transport pour compte de tiers (TPA) serait favorable pour les consommateurs.

Les partisans de cette thèse posent le postulat suivant: le TPA devrait être favorable pour les consommateurs, tous consommateurs confondus, sauf peut-être pour les consommateurs domestiques. Pour ceux-ci, on est prêt à admettre une réglementation spécifique.

Les gros consommateurs veulent le marché "libre" pour pouvoir faire jouer la concurrence et obtenir des prix d'achat de gaz inférieurs pour leurs activités. Les petits consommateurs qui ne veulent pas (ou ne peuvent pas) prendre ce risque et qui préfèrent avoir la sécurité d'approvisionnement devront en payer le prix! Le surcoût de cette sécurité est explicitement prévu par les supporters du TPA, le consommateur domestique est donc prévenu.

Même lorsque le consommateur dispose de la bi-énergie, par exemple étant amené à changer la chaudière de son chauffage central il opte pour une chaudière à gaz et conserve son ancienne chaudière au fioul, ce qui régle son problème de sécurité d'approvisionnement, mais même dans ce cas le consommateur n'a pas la possibilité de choisir son distributeur de gaz, les impératifs liés à l'installation d'un réseau feront que toujours il aura à faire face à un monopole de fait. En aucun cas, le consommateur domestique n'a le choix de son distributeur, il est prisonnier d'un monopole et qu'importe alors la taille de celui-ci, il est alors simplement souhaitable pour lui que ce monopole soit le plus performant possible au niveau des coûts et des tarifs!

Les travaux du CC Gaz ont bien démontré ainsi la nécessité de l'existence d'un marché réservé pour les ménages avec obligation de pourvoir à leur sécurité d'approvisionnement. Celle-ci engendrera obligatoirement un surcoût qui sera supporté par les consommateurs, de plus la

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lutte sur les prix pour arracher le marché des gros consommateurs risque de se répercuter sur les prix pratiqués pour les ménages qui sont bel et bien une clientèle captive, là encore ils risquent de faire les frais de cette bataille commerciale.

Le "TPA" ne peut donc qu'être préjudiciable au petit consommateur, et c'est lui qui supportera la plus grande partie du surcoût qui en résultera.

Nous tenons à rappeler, par ailleurs, que les consommateurs domestiques de gaz représentent plus de 45 % de la consommation de cette énergie, et qu'en pratique ce sont eux les plus gros consommateurs: Il faudrait peut-être en tenir compte!

De plus certains producteurs estiment que le prix du gaz devrait augmenter à l'avenir en raison des qualités propres à cette énergie, en particulier parce qu'elle est respectueuse de l'environnement. Les consommateurs sont très sensibles à la sauvegarde de leur cadre de vie, mais ils soulignent la contradiction qui existe entre cette affirmation et celle qui affirme que le TPA devrait permettre un abaissement des prix!

En conclusion: les travaux du Comité ont mis en évidence qu'il y avait beaucoup d'intérêts contradictoires en jeu, mais ce qui semble certain, c'est que le consommateur domestique n'a pas un pouvoir de décision correspondant à son poids économique réel. Le "common carrier" et même "l'open access" se traduiront par un "surcoût" du transport qui sera supporté par l'usager qui aura opté pour la sécurité, c'est à dire la fourniture de gaz 365 jours par an !

Inutile de préciser que très peu de clients domestiques auront une véritable liberté de choix: pour eux ce sera :
"Tais-toi et paye!"

PAUL EMAER
Vice-Président
Conseil Consultatif des Consommateurs

A Bruxelles, le 26 Avril 1991

ANNEX 5

E&P Forum

The Oil Industry International Exploration & Production Forum
25/28 Old Burlington Street London W1X 1LB
Telephone: 71-437 6291 · Telex: 919707 · Fax: 71-434 3721

Our Reference GT/GR/6.3.18/2345 9th April 1991

Mr. C.L. Jones
Directorate General for Energy
Commission of the European Communities
Rue de la Loi 200
B-1049 Brussels
Belgium

Dear Mr. Jones,

PROFESSIONAL CONSULTATIVE COMMITTEE ON GAS (PCCG)

The E & P Forum has received copies of the minutes of the tenth meeting of the PCCG held on 26th March from the producers' representatives on the Committee and has the following comments.

We appreciate your efforts to reflect producers' views in the final PCCG report and assume you will take into account the points raised by our members on 26th March. Attached is a copy of the E & P Forum's position paper on the effects of a regulated system of third party access (TPA) on the European natural gas industry. We understand that this position paper will be annexed to the Commission's final PCCG report. We will provide the requested French and German translations to you in the next several days.

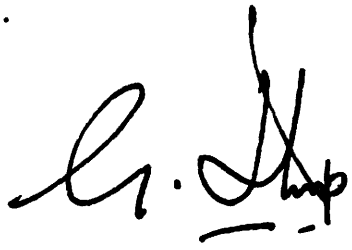
We wish to reiterate our concern, as expressed by our members at various PCCG meetings and in writing, that the Commission has adopted a consultative process which appears to address TPA as if a decision to go forward with a proposal to initiate a regulated TPA system has already been taken, and the PCCG is simply legitimizing the decision and attempting to minimize the risks associated with its implementation. The work of the Committee was strictly defined by the Commission to look only at TPA and did not allow the PCCG to examine the overall objectives that the Commission is trying to achieve. The constrained scope and inadequate timetable effectively frustrated any attempt by the Committee to provide a thorough analysis of TPA, and we request that our concerns regarding scope and timing be documented in the final report.

Although one of our members (Marathon) remains supportive of the concept of TPA, that member shares our concerns with respect to the imposition of extensive regulation.

Executive Secretary **Geoffrey Thorp**

Our members look forward to continuing the dialogue with the Commission on this important issue.

Yours sincerely,



Geoffrey Thorp
Executive Secretary

Enclosure as above

c.c. PCCG Members/Alternates
Mr. C.S. Maniatopoulos
Mr. J. Stern

E&P Forum

The Oil Industry International Exploration & Production Forum
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E AND P FORUM POSITION PAPER

EFFECTS OF A REGULATED SYSTEM OF THIRD PARTY ACCESS ON THE EUROPEAN NATURAL GAS INDUSTRY

The E & P Forum is an international oil and gas industry association that deals with international issues with some fifty members from seventeen countries. Many of the members are represented in the European Community and have significant upstream operations in most of the Community States. The E & P Forum represents the oil and gas industry's interests with international regulatory bodies.

POSITION SUMMARY

The European Community Commission is considering a regulated system of third party access to the European natural gas transportation system.

The E & P Forum has studied the possible effects of regulated third party access on the European gas industry and has concluded that there are likely to be serious long-term adverse consequences for the Community. The establishment of a regulated system of third party access would:

1. reduce the availability of long-term, secure gas supplies to the European Community,

2. inhibit future expansion of the European gas grid,

3. limit increased substitution of gas as a primary fuel and the consequential environmental benefits, and

4. shift away from free market forces toward unnecessary regulation.

The stated objective of regulated third party access is to ensure that competition and free market forces are operating in the gas market place. The European gas industry, which has developed through commercial negotiations, provides a competitively priced supply of gas to consumers and has demonstrated its ability to respond to significant demand and price fluctuations. The E & P Forum fully supports the concept of a competitive gas market in which market forces play the dominant role. However, a new imposed regulatory system is not warranted. Instead, the removal of existing obstacles to free trade should be considered, specifically (a) the elimination of import and export barriers, (b) the relaxation of restrictions on new pipeline construction, and (c) the improved application and effectiveness of existing Community law. These actions would harmonise conditions in Member States and thereby further facilitate the movement of natural gas on the basis of market forces.

Executive Secretary Geoffrey Thorp

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Due to the environmental, energy diversification and supply security benefits of natural gas over other hydrocarbon fuels, gas usage should be promoted and the development of Community gas resources encouraged. Neither objective will be achieved through the introduction of a regulated system of third party access, which is likely to be restrictive, cumbersome and costly.

1. REDUCE THE AVAILABILITY OF LONG-TERM, SECURE GAS SUPPLIES TO THE EUROPEAN COMMUNITY

Large increases in European gas demand are forecast well into the next century, far in excess of existing production and delivery capabilities. Because of geological limitations, Community gas production is expected to remain at about current levels, but only through the development of smaller and substantially more expensive fields to replace currently producing fields as they are depleted. Member States on the continent are already dependent on the Soviet Union and Algeria for approximately one-third of their gas needs, and increasing dependence on major new import projects is inevitable.

The economics of gas field developments typically compare unfavourably with those of oil fields due to less attractive production profiles, lower prices per energy unit, higher transportation costs and reduced marketing flexibility. Producer investment decisions are based on extensive risk versus reward analysis, involving large upfront investments and long lead times that, particularly for major gas import projects, are often much greater than those in the oil business. For that reason, gas producers and their lenders look for offtake assurances, typically through long-term sales contracts with minimum payment ("take or pay") provisions.

Gas producers depend upon market intermediaries who, in aggregating the diverse needs of many gas consumers, not only create an adequate demand base for major projects but are also able to offer long-term, guaranteed gas contracts. Regulated third party access will cause gas companies and other potential major gas buyers to be less certain of their future gas requirements and will adversely affect their willingness or ability to undertake new long-term purchase and investment commitments. This in turn will reduce producers' ability and incentive to explore for and develop the new gas supplies required by the European market. During a Statoil presentation to the Professional Consultative Committee on Gas, the Norwegian government confirmed that long-term take or pay contracts are essential to demonstrate the commercial viability of developments and will continue to be prerequisites for project approvals.

In addition to the threat to new developments, regulated third party access could erode gas companies' demand bases to the extent that their sales would fall below their minimum offtake

levels under current purchase contracts. This was a major problem in the United States as a result of heavy government regulation. Producers are not satisfied that suggested "transitional arrangements" have been considered fully nor that they will protect intermediaries from the adverse consequences of regulated third party access.

2. INHIBIT FUTURE EXPANSION OF THE EUROPEAN GAS GRID

Producers have an inherent interest in expansion of the gas market and the increased market penetration which will result from the connection of new regions to the European gas grid. Provided that producers' and transporters' investments can be economically justified, this expansion is expected to continue. Regulated third party access would make it increasingly risky and difficult to justify pipeline projects, as the gas companies' demand bases are fragmented and project financing becomes more difficult to obtain. As a result, infrastructure investments would tend to lag rather than anticipate increases in demand.

The use of "transitional arrangements" has been suggested to provide investment security for new major infrastructure projects by means of exemption from proposed third party access regulation. Without full consideration and definition of the nature, duration, and application of such arrangements, it is impossible to judge whether they would be either practical or effective.

3. LIMIT INCREASED SUBSTITUTION OF GAS AS A PRIMARY FUEL AND THE CONSEQUENTIAL ENVIRONMENTAL BENEFITS

The increased substitution of gas for alternative fossil fuels is a key objective of the Commission, in large part due to the environmental benefits of a reduction in harmful emissions. A threat to the future availability of gas production and transportation capacity due to regulated third party access is a threat to the potential benefit for the environment that increased gas use would produce.

4. SHIFT AWAY FROM FREE MARKET FORCES TOWARD UNNECESSARY REGULATION

There is fierce competition from a wide variety of alternate fuels at all phases of the gas chain. In addition, gas-to-gas competition at the wholesale level already exists as various suppliers from inside and outside the Community compete for new sales. Furthermore, the fact that 30% of the European Community gas supplies currently transits at least one Member State, and 50% is subject to international trade demonstrates that additional regulation is not required. This movement of

gas has so far occurred as a result of sound commercial arrangements rather than legislation.

In preference to regulated third party access, the Commission should give priority to harmonizing national laws and to enforcing and rationalizing existing Community regulations to ease their application and improve their effectiveness. A system of regulated third party access will add an unnecessary layer of control and will contribute additional administrative costs and burdens. It seems odd for the Commission to be considering new regulations just as policy makers elsewhere are trying to dismantle their regulatory bureaucracies.

CONCLUSIONS

In summary, the members of the E & P Forum fully support the concept of a competitive gas market in which market forces play the dominant role. However, a new imposed regulatory system is not warranted. The establishment of a regulated system of third party access conflicts with established Community energy objectives and will hamper the environmental objective of increased gas utilization. The members of E & P Forum look forward to continuing the open dialogue on this important issue.

EURELECTRIC

COMITE EUROPEEN DES ENTREPRISES D'ELECTRICITE
EUROPEAN COMMITTEE OF ELECTRICITY SUPPLY INDUSTRY

91.05.03

Re: PCCG

We set out herewith EURELECTRIC's position regarding the PCCG final report.

EURELECTRIC is the European Committee of Electricity Companies, its members being amongst the largest consumers of natural gas in the CMM.

In many countries the price of gas is an essential item in the cost of electricity production.

EURELECTRIC is, like you, quite in favour of a more open and competitive European gas market.

However, EURELECTRIC is firmly convinced that the TPA is not the most appropriate means of changing the characteristics of the natural gas market.

A more in depth discussion on the TPA would enable the more essential aspects to be tackled.

EURELECTRIC regrets that the timetable and procedure for PCCG meetings has not enabled such an exchange of views to occur.

In actual fact, the PCCG report appears as a general statement of the positions expressed without however showing the weight of each of its sections. For this reason, it is doubtful that it could suffice as a basis for establishing a policy at the highest level.

This is why - also bearing in mind EURELECTRIC's comments at the PCCE - EURELECTRIC can neither adhere to the concept of the TPA as it appears in the report, nor let it be thought that they share the responsibility for it.

EURELECTRIC considers that it is their responsibility to clearly warn against the undesirable effects of the introduction of TPA as envisaged in this report.

The safety of obtaining supplies from a basic source of energy and the interests of the users - large consumers of course, but also the domestic customer - requires a more cautious approach.

Galerie Ravenstein 4, Bte 6 BE - 1000 BRUXELLES
[illegible] UERVEB B - Télécop/telefax Int: + 32 2 5113159/5127362

If the Committee so wishes, EURELECTRIC is at its disposal to examine the ways and means of improving the operation of the natural gas market or the consequences of the TPA.

ir N.G. Ketting

EUROGAS VIEWS ON THIRD PARTY ACCESS

Addendum to PCCG Report

Original version : ENGLISH

Brussels, April 1991

I EXECUTIVE SUMMARY

Eurogas, the European Union of the Natural Gas Industry, is the association of natural gas merchant and distribution companies in Europe, and it represents the natural gas industry's interests with international official bodies.

This report gives the views of Eurogas on the implications of a regulated regime of mandatory third party access (TPA) to the facilities of the gas companies in the EEC. It is intended to be an addendum to the European Commission's PCCG Report on this issue, and it consists of this Summary, an Introduction, and a detailed section on TPA and Community Energy Policy.

The European Natural Gas Industry

Natural gas is produced from wells, often in combination with oil, usually by oil companies and consortia of investor firms involved in the exploration and production of oil and gas.

The produced gas is purchased by gas merchant companies which sell it to their customers.

In executing this business the gas companies operate pipeline networks and distribution facilities including attendant activities for gas storage, quality conditioning (e.g. mixing and treating different gas types coming from diverse sources), delivery pressure, etc...

The gas industry aggregates and evens out the highly variable demand from individual gas consumers, thus enabling producers to deliver on a long-term and production oriented cost-efficient basis, and offers supply security to its customers on the basis of its diversified supply portfolio, its sales mix and its technical facilities.

Nearly half the natural gas consumption in the EC is imported from three outside sources. The aggregating merchant function of the gas industry is essential in securing long term imports at best conditions for the users as well as for the EC trade balance.

Eurogas principally wishes to address the potential impact on the achievement of the Community energy goals and on Community well being of the introduction of a TPA system.

The stated Community energy policy objectives are 'improving security of supply, reducing costs, and improving economic competitiveness' which should be seen in the context of the Community's desire to reduce dependence on oil, to increase energy efficiency, and to improve the environment. The importance of natural gas is self evident. The achievement of these policy objectives would be materially jeopardised by the introduction of TPA.

The main inter-related consequences of TPA will be adverse to the objectives of sound energy policy, entailing:

- Loss of security of supply.
- Default on take-or-pay commitments.
- The greater likelihood of increased consumer gas prices.
- The undermining of the time-proven market related system, replaced by creeping regulation and loss of efficiency, because of the desintegration (unbundling) or lack of aggregation of gas industry operations.

As a result, TPA will cause lower market penetration of gas which will have an unfavourable impact on environmental protection and improvement policies.

In short, it is the view of Eurogas that TPA is likely to create significant potential disadvantages for the Community in terms of reduced supply security, potentially increased cost of supply and conflicting economic signals.

Against these problems, there is no persuasive evidence either that so-called 'gas-to-gas competition' will occur beyond the level which currently exists at the European border as a result of the purchasing power of the gas companies (which TPA would diminish), or that such competition, if it did occur, would be in the long run interest of consumers.

Loss of Security of Supply

The introduction of TPA will risk both impairing future supply and leading to an increase of border prices which will not increase the gas availability because of increased risk on the producers' side.

At present, additional gas supplies can be purchased from three non-Community producers, and 'gas-to-gas competition' exists at the European border, through the purchasing power of the gas companies who are able to underwrite new major projects. This helps to ensure security of supply for European consumers, who in this way receive the gas they require from a well diversified portfolio at the best conditions which can be negotiated. This would be endangered by a TPA regime which would not anymore allow gas companies to offer the same high take-or-pay commitments as at present. This would make it very much more difficult, if not impossible, for the gas companies to continue to assist the development of major new supply sources.

Europe will increasingly depend on non-European sources but because new supplies will involve more remote and high cost reserves, the limited capacity of most non-Community suppliers to bear the economic and commercial risk inherent in such projects means that a shift of market risk from buyers to sellers which will occur in a TPA regime is likely materially to reduce investment incentives, and could make new investment difficult, if not impossible, thus further jeopardising security of supply. On one side, long term off-take guarantees would not be offered to producers, on the other side, supply in line with variable demand from consumers, including Local Distribution Companies, would be impaired.

A TPA regime will not encourage additional gas producers to enter the market. TPA will not reduce field development or delivery costs, nor is any evidence produced to support the suggestion that TPA would enable fields to be developed more promptly than is possible under the present arrangements. We question the suggestion that TPA will entice new producers to bring supplies to the European market; the difficulty for such suppliers would stem from neither the level of reserves nor markets, but the ability to manage financial and commercial risks. This would call into question the future levels of investment upon which the growth of Community supply is dependent.

Take-or-Pay Contracts

Exploration and development of gas production facilities, and the installation of gas transportation systems, demand increasingly huge investments with the increasing geographical distances and more costly new sources required to supply the growing gas demand in the EC.

In order to secure the funding of such projects, gas producers and gas purchasers conclude long term take-or-pay contracts which oblige the purchaser to pay the producer for an agreed regular volume offtake over an agreed period of time, whether or not the purchaser actually takes off the entitled volume in the contract period. Such contracts guarantee regular income and best possible project financing conditions to the producer, and they afford best possible gas price conditions to the purchaser.

The purchaser gas company takes the volume risk, which it will limit by aggregating as much as possible the diverse, often short term demand from individual gas consumers. The supplying gas producer, against his guaranteed sales, takes the price risk, as his selling price will be related to the prices of competing alternative energies, in such a way that the gas merchant companies are able to market the gas they are committed to take.

Default on Take-or-Pay Obligations

The existing long term take-or-pay obligations of gas companies were incurred on the basis of a known balance of risks. If this balance were disturbed by TPA it could bring companies in a position where they would no more be able to take off the contracted volumes and thus default on these take obligations. As a consequence, financial difficulties could arise, the nature and severity of which depending on the particular situation. Unless government intervenes a series of problems would arise, among which higher cost and lower penetration of gas. Such financial difficulties would have a lasting negative impact on the gas companies' ability to enter into new take-or-pay commitments in order to ensure long term security of supply.

Either way, these developments would be at the expense of the consumers notably the small consumers, or the European taxpayer.

Increased Consumer Gas Prices

TPA is unlikely to lead to lower burner-tip prices. Recovery of capital and operating costs associated with serving consumers by the gas merchant companies represents a small component of burner tip prices. The assumption that TPA could reduce such costs is not plausible. Increased inefficiency caused by forced unbundling and regulation would increase costs instead (see below). Lower energy market penetration of gas would add to the unit costs.

The argument that TPA will enable consumers to explore alternative purchasing options, and thus exert downward pressure on prices, is most unlikely in a situation of tight supplies in which the gas companies have the better purchasing power. Increased competition between gas buyers will then cause a bidding up of purchase prices, which would serve to compensate for the higher financial risks of producers, and as such not provide real incentive to invest (see above).

Creeping Regulation

The effect of a regulatory regime on the capability of companies to undertake investment is a matter for concern. Given the diversity in accounting procedures, depreciation provisions, tax conditions, inflation, and related matters in the Community, and the wide range of activities which could ultimately become subject to dispute, a legally binding Community instrument would not prove viable. Increasingly heavy bureaucratic regulation would impede investment, hinder growth, increase costs and divert resources away from meeting the needs of consumers.

There would be a large number of problem areas, such as determination of available capacity, capacity allocation, cost allocation, gas quality, customer priority. The complexities would be considerable.

An obligation to invest in additional capacities, sometimes proposed towards a solution to the aforementioned problems, would imply an even deeper regulatory intervention and would require careful legal review. Such an obligation on terms judged 'reasonable' by a regulatory agency would also raise major issues of Community policy, which are not addressed here, and which would have a most doubtful legal basis.

Moreover, the regulation could militate against the very policy it is intended to accelerate. By fragmenting demand during an extended period of potentially tight supply, TPA would shift market power towards non-Community suppliers. It would promote regionalisation resulting in regional dependence on individual producers, contrary to the stated objectives of the internal market policy and reduce diversification of gas supply. The potential cost of this to the Community, in both economic and political terms, and hence to consumers and taxpayers is immense.

Concluding Remarks

While the completion of the European single market will change many aspects of the Community, and Eurogas is facing the challenge of the future, TPA will not serve the long term interests of Europe's gas consumers or citizens. These interests will be better served by removing existing barriers to EEC market integration such as differences of taxation and environmental protection requirements, and by strengthening the existing market-related framework. In addition, the existing possibilities for prevention of abuse of market power are enshrined in the EC Treaty, and their observance should ensure enhanced efficient market-related structures and performance.

In view of the need to enhance efforts to increase gas penetration and to contribute to environmental protection, to invest in the infrastructure required and to develop the integration with countries in central and eastern Europe, the gas industry needs continuity of the legal framework, including the minimum of bureaucracy, which will enable it to pursue the necessary huge investments.

The introduction of a TPA regime would be a high risk experiment. No TPA system exists today in a region presenting significant differences in fiscal and organisational aspects of the industry, in which there is increasing dependence on suppliers not subject to the same legal and political regime, and in which TPA has proven to function properly, in particular in a tightening market environment, without entailing creeping regulation.

II INTRODUCTION

1. Eurogas has prepared this report on TPA because adoption of a TPA regime would have important repercussions on all aspects of the gas industry, and the consumers. In considering whether such measures are desirable, it will be essential that:

   - A careful review is made of the contribution that the European gas industry has made to the achievement of Community energy policies, in order to identify any areas in which progress may be required. TPA would then be evaluated against clearly identified defects in the present operations of the European gas industry.

   - A structured analysis of major Community energy priorities is made in the context of the expected environment in which the gas industry is likely to operate over the next decades, to determine whether the potential advantages of TPA were greater or less than the potential disadvantages.

2. Eurogas wishes briefly to recall the contribution which the European gas industry has made to the development of the Community, against which background and experience, Eurogas advises on the TPA issue. In 1965 natural gas provided 2 per cent of Community primary energy demand: last year, gas' share was 18 per cent, representing a twelve-fold increase in consumption. In consequence, Community oil dependency has been significantly reduced. The gas industry has been able to secure supplies from costly sources in the North Sea, Siberia, North Africa as well as from important domestic resources. This growth in supply has come about because the gas companies have been able and willing to support the many billions of ECUs of investment required to realise these projects. Moreover, these investments have been undertaken in a period of unprecedented energy price volatility and fierce inter-fuel competition. During these turbulent times, the security of consumers' supply has been maintained without curtailment, and the industry has respected its commitments. International trade in gas has increased, prices have been very competitive against alternative fuels, and huge investments have been made both inside and outside the Community.

   Major transmission pipelines in Europe are already operating at a very high load factor - usually higher than most of the major US interstate pipelines, for instance.

   The success of the European gas industry in adapting to changing circumstances is due, in no small measure, to its basic structure, which has permitted it to mobilise the necessary resources, and which will enable it to further evolve in the face of market development needs, and to address the challenges of future investment requirements.

III TPA AND COMMUNITY ENERGY POLICY

'Improving Security of Supply'

1. A central issue for the future of the European gas industry is the Community's rapidly increasing dependence on non-Community suppliers, principally the Soviet Union, Norway and Algeria. These countries today supply some 40 per cent of Community gas, and it is inevitable, in our view, that, if as the Commission expects, gas demand continues to increase rapidly, so will Community dependence on these countries, since few, if any, new major suppliers are expected to appear in the near future.

2. This judgement reflects what we believe to be a widely held view that the in-place gas reserves of the Community are, at credible depletion rates, unlikely to do more than sustain Community production at current levels. It follows from this that, under present circumstances, the Community will be virtually totally dependent on a few major non-Community suppliers for future incremental supply.

3. One response to this prognosis would be concern that adequate incentives exist to encourage further efforts to increase and diversify Community gas supply. The Eurogas view of the arguments is set out in the following.

4. In the analysis, two other important issues must be raised, namely:

   - Would TPA diminish or enhance the capacity of the Community to manage its growing dependence on external supplies?

   - Would TPA encourage or discourage a diversification of non-Community gas supply, as a means of discouraging dependence on a few proximate suppliers?

   We believe that, on balance, TPA is very likely to reduce the capacity of the Community to manage its growing dependence on non-Community suppliers and thus reduce security of supply:

   - As a result of fragmentation of purchasing power, the imbalance between the negotiating strength of buyers and sellers is likely to shift in favour, in the anticipated tight supply situation, of non-Community sellers.

   - In a time of tight supply, 'shopping around' could lead to producers perceiving an even tighter supply situation than was in fact the case (since they could receive multiple enquiries in response of the same needs) and thus provide incentives for unnecessarily large price increases (bidding-up).

   - A reduced capacity to provide offtake assurance will jeopardise the commercial development of some new supply sources.

   - Natural gas consumers on the periphery of Europe could become 'captive' to non-Community producers as a result of TPA.

5. The effective 'negotiating strength' of the Community is likely to reflect, not simply the perceived future supply/demand balance, but also the ability of buyers to balance the potential market power of a few sellers. Even the largest individual consumers or Local Distribution Companies will be unable to match the buying power of the gas companies who are, we believe, in the best position to do so. In a demand-driven market, TPA seems likely not to result in competition between producers for markets, but rather competition between consumers for access to gas supplies. The 'bidding-up' process would lead to the possibility that the market would not grow, because gas would be priced out of certain low-value outlets, with the consequent loss of penetration and of potential environmental improvement.

6. In the past, the purchasing power of the gas companies, coupled with their ability to support the huge investments needed to bring large new supplies to market , has enabled them to offer the offtake commitments required to support the development of major new supply sources.

7. We judge that TPA would, by eroding the capacity of the gas companies to share the risk of new high-cost projects, reduce the capability of the European gas industry to diversify its supply by bringing new sources of gas to the market. Gas companies would, under a TPA regime, be unable to offer the same level of long term 'take-or-pay' offtake commitment that they have in the past. Producers recognise this, and have expressed concern at the consequence of this on the development of new sources of supply.

   As a case in point, we believe that prospects for the successful development of the Nigerian LNG project (which would provide access to a resource base broadly equivalent in size to Algeria's), and of the Russian Barentsz Sea project in future, would be made significantly more difficult if potential purchasers felt (as they would) unable to offer the level of take-or-pay obligation which has historically been available. We believe that, given the high level of borrowing required to support the project, lenders would take little comfort from the theoretical market need for new gas supply, and need to retain the type of arrangement which has, in the past, proved satisfactory to them.

   As the costs of developing gas reserves have increased, because of their increased remoteness and technical difficulty even the gas companies have been obliged to join forces to support the huge financial obligations required: we doubt that even the largest industrial users would be willing to make the same commitments.

8. In addition, to the extent TPA were to be based on distance - related transmission/distribution costs, it will inevitably make it more expensive, and thus unattractive, for suppliers either to serve markets in the centre of the Community or, more importantly, to diversify their sales across the Community.

   Thus, non-Community suppliers could face the opportunity to 'capture' outlets close to their delivery systems and even to come to a de facto market sharing agreement on a regional basis. This could seriously jeopardise physical supply security by impairing the Community's ability to develop a diversified portfolio of supplies.

9. It might be argued that, in such cases the gas companies might be obliged to provide 'back-up'. However, to the extent that such back-up is not guaranteed, it is of small value. In the alternative, if at all possible, the necessary back-up will require substantial investments.

10 Sometimes, it is argued that under a TPA system consumers would be able to reach an informed judgement as to the trade-off between cost and security of supply. In practice, it is unlikely that such an assessment could be reached with a high level of confidence.

The reason for this conclusion is, that we believe it is unlikely that consumers negotiating to purchase gas directly from producers under a TPA system would easily find alternative offers sufficiently comparable for them to be able to weigh up relative advantages and disadvantages. Independent storage, load balance and other service operators are likely to face significant cost penalties, which will further complicate the 'cost/security trade-off'. TPA is further likely, by segmenting risk which is currently diversified across gas companies, either to decrease security of supply or increase the cost of supply security.

'Reducing Costs'

11. TPA proponents suggest that competition would lead to lower gas prices, and that it creates the opportunity for consumers to explore alternative purchasing options. They also claim that a decoupling of gas prices from competing energies prices would exert downward pressure on gas prices.

It is extremely doubtful, in our view, that a decoupling of gas from competing energies would ultimately prove beneficial to consumers. We judge that the immediate, short term result would be a decline in development of domestic gas resources. In the longer term, decoupling would, as US experience has shown, lead to potentially huge shifts in demand. During periods of high oil prices, gas demand would tend to increase to levels potentially unsustainable at long run cost levels ; during periods of low oil prices consumers would seek to switch back to oil, leading to greater difficulty for gas companies in meeting their contractual commitments. If such distortions are to be discouraged, the price of gas must track the prices of the energy sources with which gas competes. In short, if supply is to be stable, prices must reflect the value of energy on world markets; if they do not, supply and demand will inevitably (as in the US) show dramatic fluctuations with a consequent reduction in consumer security and increased investment risk.

12. TPA proponents believe that TPA in itself will not substantially influence the commercial balance of risks and opportunities between gas producers and gas purchasers. As important will be judgements whether market (supply/demand) conditions favour buyers or sellers.

As it is uncertain and, in the view of Eurogas, highly unlikely, that these market conditions in this decade and thereafter would favour buyers, any downward effect

of TPA on gas prices would have to spring from lower transportation cost, at any level of well-head or border prices.

In a genuine market for transportation services, if any, it would appear logical to allow capacity to be allocated via the market price mechanisms, rather than on the basis of costs, because then capacity will be attributed in accordance with the use value for the consumer. Furthermore, allocation on a cost basis will not give the adequate incentives for efficient conduct of the gas companies' business (gold plating).

We remain unconvinced that a cost-based approach will be viable without costly and burdensome regulation, which is likely to lead to 'arbitrary' cost allocation procedures leading, inevitably, to dissent and conflict. A system which, directly or indirectly, allows commercial decisions to be 'second guessed' by organisations without financial accountability is likely to create a new and damaging element in investment appraisal.

The argument that effective, lower transportation charges arising from a TPA regime would lead to lower consumer prices, in our view, is not valid.

We think that the cost of servicing customers would increase because of the loss of efficiency caused by the desintegration (unbundling) or lack of aggregation of gas supply operations, and because of the resulting lower market penetration. Moreover, recovery of capital and operating costs associated with serving consumers by the gas merchant companies represents a small component of burner tip prices. Even assuming that TPA had the effect of reducing such costs, the resulting reduction in price, if any, for most customers would be extremely small.

13. Should, however improbably, the cost of servicing decrease, then such economy would not likely benefit the consumer, but would be translated into increased border prices benefiting the gas producer. Non-Community suppliers would take this opportunity to increase border prices by an equivalent and offsetting amount. They would regard this as compensation for the reduction in offtake security which TPA would bring.
As such, higher prices reflecting increased producer investment risk would not lead to greater supply.

It is unlikely that a way could be found to prevent non-Community suppliers from pursuing their commercial incentive to set wellhead prices on the basis of the cost of alternative energy sources less internal (European) gas transmission and distribution costs. The Community cannot meet current domestic requirements; in the future it is unlikely to avoid seeking to satisfy virtually all growth in demand from non-Community suppliers. In this situation, a more transparent and lower internal cost structure would simply be an invitation for non-Community producers to increase border prices. As an example, a reduction in internal cost of $0.1/MMBtu would represent, in current terms, a negative balance of payment impact of some ECU 270 million p.a. (a sum which could easily double by 2000) if this were translated into higher prices at the European border.

'Improving Economic Competitiveness'

14. There is a potentially serious inconsistency in the signals being sent to producers and consumers, alike, by the passage of legislation intended (whatever the likely effect) to reduce short-run gas prices at a time when the Community needs to encourage new suppliers, whom, we judge, will typically be high-cost producers, to enter the market.

    The potentially damaging effect of such economic signals can be seen from experience both in the US (where regulation ultimately created both the gas scarcity of the 1970s and the gas glut of the 1980s) and in the UK, which in the late 1970s was forced carefully to consider the appropriateness of prevailing consumer price levels in the light of perceived long run marginal cost. After due consideration, the UK Government, in 1979, instructed British Gas to increase tariff prices by 10 per cent p.a. in real terms, over a three year period, in order to signal to consumers the rising long run cost of accessing future resources. We believe that Europe now faces a similar situation to that perceived in the UK in the late 1970s, of increasing long-run marginal cost, and that TPA would provide fundamentally misleading economic signals.
    Clearly, in providing appropriate consumer price signals, the Community does not wish needlessly to increase the balance of payment burden of gas imports; equally, however, it will not wish to send to consumers signals which are diametrically opposed to those which are required to support the future growth of the market.

15. Other economies which provide appropriate signals to both producers and consumers will create an economic system which is more closely attuned to the realities of resource depletion and is, thus, intrinsically more competitive, in the sense that it is better placed to react to future increase in natural resource costs.

16. There is a serious concern that a TPA regime would, by eroding the capacity of gas companies to sign long term take-or-pay commitments, increase the financial cost of gas development and thus, at any given level of prices, reduce the resource base economically available to domestic producers, particularly in view of increasing long-run marginal cost.

17. In addition to the impact of loss of offtake security on highly leveraged projects, we judge that a parallel, but less extreme, upward cost pressure would occur even where the producer had the financial capability to spread risk on a diversified basis. This is likely to occur since, at the margin, development of oil reserves would be preferable to development of gas, and thus provide an incentive to refocus development effort away from gas.

18. Thus, we are forced to conclude that, in the industry environment which is likely to apply over the next decades, the introduction of TPA would be detrimental to the energy objectives of the Community, as set out in September 1986.

19. It is understood that Community policies are under review. We would expect that the revision of policies will strengthen the emphasis on security of supply and environmental protection, thus reinforcing our reservations against TPA.

DG XVII PROFESSIONAL CONSULTATIVE COMMITTEE ON GAS (PCCG)

POSITION STATEMENT BY MR IAN POWE

Third Party Access (TPA) as defined in the PCCG final draft report is:

> "A scheme providing for a qualified obligation on companies, operating natural gas transportation facilities, to offer terms for the use of their system".

Objections to the introduction of TPA centre on three main issues:

- TPA would diminish the financial incentives for gas exploration and production. As a result, security of supply would be jeopardised.
- Consequent competition might cause bidding up of prices.
- Regulation would be complex and disruptive to the market.

These objections show a misunderstanding of TPA as defined. They are only valid in a scenario where the present market structure and its related network of long term contracts and "take or pay" agreements disappear completely.

The TPA obligation will always be qualified rather than total. It will be a matter for regulatory judgement to ensure that TPA is qualified so that it may not be introduced in a manner and at a pace that will allow security of supply to be jeopardised, prices to rise or regulation to stifle the market. This can be achieved through an evolutionary approach whereby TPA is, at first, applicable to the purchase or sale of gas in such volumes that only a few very large consumers or local distribution companies would be qualified to enter the TPA market. The total volume sold under initial TPA agreements should be limited, by regulation, so that present supply and access arrangements can at first remain in place alongside an evolving TPA market.

As TPA develops, new forms of contract will emerge to form a portfolio of purchase commitment and risk sharing arrangements, including long term agreements with take-or-pay clauses, which financiers may find acceptable when deciding whether to fund exploration or production projects. If market attitudes alter, in response to changes in its structure, regulatory authorities will be able to consider the admission of smaller consumers to TPA while preserving security of supply and pricing guarantees. In due course, household consumers would benefit from TPA through market success of local distribution companies. It is possible, and acceptable, that TPA will only thrive while overall gas demand is on the increase; if demand falls, regulation to ensure security of supply may be more important than regulation to promote further competition through wider TPA facilities.

Ian Powe
Director UK Gas Consumers Council
10 April 1991

INTERNATIONAL FEDERATION OF INDUSTRIAL ENERGY CONSUMERS EUROPE

IFIEC EUROPE

Siège :
111-113 Chaussée de Charleroi
Bruxelles (Belgique)

Brussels, 4th April 1991

Re: PCCG Final Report

GENERAL STATEMENT
Original

PROFESSIONAL CONSULTATIVE COMMITTEE ON GAS

1- GENERALITIES

IFIEC Europe assessment.

The initial terms of reference proposed by the Commission and adopted by all the Delegates invited to participate in the Professional Consultative Committee on Gas (PCCG) stated:

> To identify and present the main technical, economic and administrative considerations which should be taken into account in Community policy on whether and, if so, in what form and by what means third-party access to gas transport system should be provided.
>
> It was agreed that both transmission and distribution systems should be covered by this remit. The Committee was asked not to consider legal questions.

The Committee was asked, as a group of experts, to assist the Commission in identifying these factors. An objective view taking into account the various opinions of the participants was to be drawn up in a Committee report, with the understanding that any points on which disagreement remained should be clearly recorded therein.

An IFIEC Europe Delegate was invited to participate in the PCCG meetings on behalf of Industrial Energy Consumers. His assessment of the PCCG procedures is:

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a) Throughout all the PCCG meetings there has been a wide range of views expressed by the PCCG Delegates. Although IFIEC Europe Delegate does not share all these views, he supports the principle whereby divergent views should be given equal expression.

b) He has always stated that he will accept the Final Report on the condition that all views expressed are duly reflected, thus providing a balanced and objective Report which fulfills the Committee's aims as set out in the initial terms of reference.

The opportunity has been offered to IFIEC Europe to make a clear statement of its particular views; IFIEC Europe welcomes this opportunity and submits the following statement, clearly defining its position.

2- THIRD PARTY ACCESS (TPA)

IFIEC Europe objectives.

- A -

In the Introduction of the Final Report, (§5 page 10), it is stated that "the Committee was not asked by the Commission to make specific recommendations on whether or not TPA should be introduced in the Community's gas transport system". IFIEC Europe would therefore like to give the main reasons why its members support TPA here.

* TPA is not an end in itself, but a means to:
** develop a market for natural gas, (designated hereafter as "gas"), more compatible with the spirit of the Treaty of Rome;
** improve the current situation where Consumers are effectively captive Users. In most cases they are obliged to adapt to tariff structures which are imposed;
** introduce more flexibility and competition by opening up new opportunities of choice for Producers, Distributors and End-users.
* Due to TPA, this power of choice may, as in all other competitive markets:
** provide strong incentives for increasing efficiency and reducing costs of supply;
** achieve a better balance in the relationships between Suppliers and Consumers;
** improve responsiveness to each party's needs;
** facilitate a greater diversity in contracting practices, offering more options, and allowing Consumers a greater role in decisions affecting their supply arrangements.
* Additionally TPA:
** would enable new entrants and new technologies to participate in the market, creating a broader exploration and production base, enhancing differentiation in order to

respond to developing market needs and attracting new sources of capital. Such new opportunities would undoubtedly increase, not diminish, security of supply.

* Due to TPA:

** large scale Industrial Consumers, members of IFIEC Europe, will be, and in some cases are already, able to sign long term contracts with Producers. Those long term contracts would aid investment planning and hence, security of supply;

** the existing regulatory bodies in Europe, in many cases, will become redundant, offering to the system of regulation an opportunity to become much smaller, more flexible and transparent, for independent resolution of disputes;

** in accordance with the Commission and the Parliamentary decisions, the traditional structures of the Supply Industry in place today, (monopoly rights, national sales obligations etc), will be progressively adapted to respond to the need for greater Consumer choice and influence in gas supply.

As already stated within the objectives of a true gas market, IFIEC Europe wants and supports TPA, providing it should not become a source of discussions to disguise real objectives, and be confused with references to security of supply issues.

Similar opportunities of choice in the gas market should be extended, on a non-discriminatory basis, to independent Producers and End-users, including the Gas Consumer Industry and Local Distribution Companies acting on behalf of Small and Domestic Consumers.

Industries -and the same applies to Local Distribution Companies- must have the option to contract for purchases of gas under terms and conditions which suit them and which are linked to conditions in the market. Important conditions are e.g:

* Pricing - the ability of buyers to negotiate price terms which reflect the needs of their business;
* Contract durations - appropriate to business needs, investment decisions;
* Quality: for some, this means stability in terms of firing characteristics; for others, chemical composition;
* Level of reliability of supply - appropriate to the needs of buyers (potential for interruptible contracts).

- B -

IFIEC Europe has a high respect for the technical expertise and transmission network control experience on which security of supply depends. It accepts the key role of the transmission network controllers. However from the PCCG discussions it appears that there are no insuperable technical obstacles to TPA.

- C -

TPA should be included in the future Community Energy Policy as formulated:

1- In terms of completing the Internal Energy Market, the EC documents:

* the Commission working document COM(88)238 Final;
* the Communication from the Commission to the Council and the European Parliament COM89(334) Final;

clearly raise the issue of TPA in terms of implementation of a more integrated European market;

2- More recently, the draft European Energy Charter proposes, among its operational goals, "the development of trade, particularly through the free functioning of the market, free access to resources and the development of infrastructures".

IFIEC Europe believes that the ultimate success of such emerging Community initiatives as:

a- The development of independent power;
b- the development of industrial self-generation, highly efficient combined heat and power generation;
c- the development of renewable, alternative fuels, etc;
d- the need to increase energy efficiency,
e- the need to better protect the environment
f- the development of Community-wide interconnection networks will depend, in the main, on the extent to which Consumers are given a more active role in the decision-making processes associated with these initiatives.

In the past the Gas Consuming Industry has played a major role in gas production across Europe. As a key initiator of the existing European gas Industry, and as a vehicle of economic development on which economic growth and social welfare depend, the Gas Consumer Industry also has the expertise and experience to play a greater part in reaching the Internal Energy Charter objectives.

- D -

A major argument in favour of TPA is the environmental one. The flexibility introduced by TPA would encourage CHP schemes. Industry's investments in CHP will have a significant impact on energy efficiency and will reduce CO2 emissions. With the TPA option, the share of gas in the fuel market will increase at the cost of fuel oil. Lower emissions of CO2, SOx and NOx would be the beneficial result.

- E -

Freedom to obtain the gas supplies best adapted to the Consuming Industry's specific needs is fundamental to Consumers' overall viability, which is, in turn, essential to the Community's long term well-being. Industrial investment is capital-intensive and long term in scope. Supply conditions are often a key factor in the choice of a plant site; in addition, for Industries which have to be situated close to their down-stream markets, energy costs may be a critical factor that determines the commercial margin and ability to remain competitive. In many cases, project financing for industrial development in the future will depend, in part, on Industry's ability to procure long-term energy supplies under competitive conditions.

The Gas Consuming Industry today is world-wide in scope and obliged to operate in competitive markets that do not offer automatic pass through of costs. Choice of supply, flexibility, supply security and balanced contractual relationships are the "heart" of TPA.

IFIEC Europe asks that careful, objective consideration be given to the overall long term benefits of introducing competition and consumer choice to the European gas markets as they evolve, progressively, into a more integrated Community configuration. TPA should be at the center of energy policy discussions in the coming months, not as an instrument of chaotic change, but as a means to flexible problem solving that will allow Gas Consuming Industry to pursue a course of dynamic economic development within the Community in the years ahead.

THE DESIRABILITY OF THIRD PARTY ACCESS (TPA)

Position statement of a gas distribution company.

1. Europe without internal borders

The structure of the public gas supply industry in the various Member States is determined on the basis of national considerations and has sharp national delimitations. This has led to the situation that on both sides of the current internal borders completely different structures are found. On the basis of this mere fact it may be concluded that it will be impossible to maintain the current national structures when the single internal market has been established. So it is not a matter of whether there will be any change, but of which direction the change will have to take. In fact, the choice is between incorporation of the current nationally defined structures into a centrally developed EEC structure and an essentially different approach: a more open energy market. The latter option is to be preferred for many reasons. A more open energy market offers possibilities for better bringing out the diversity within Europe; by competition it leads to higher efficiency and it offers the best perspectives for further development of the European gas market by opening up the East-European gas potential.

A more open energy market is not feasible without a solution for the apparent discrepancy between an open market and the natural monopoly of gas transmission and gas distribution. TPA is that solution. TPA provides the conditions for a more competitive gas market while retaining the efficient use of the existing and future - expensive - gas supply infrastructure.

2. Competition in gas supply.

At present gas to gas competition is totally absent in the national gas supply industries. The introduction of such competition will improve efficiency, which will be to the benefit of the consumers. In this situation it will be necessary, however, to alter the existing gas pricing methodology (full linking to oil products prices). By that methodology efficiency gains realised by the LDCs are automatically translated into higher purchase prices and, consequently, into higher revenues for the transmission/production companies. Thus, in the present situation consumers do not benefit from these efficiency gains.

3. Security of supply.

One characteristic of TPA is that supply and demand can meet directly, without intervention of the merchant/transmission companies. The gas price is then determined by the supply and demand interactions on the gas market (gas to gas competition). When there is a surplus of gas, the price will drop to below the level of the equivalent oil products. This will be to the benefit of the consumers. In times of relative shortage the price will rise (above the level of oil products price), which is only fair. If this occurs in the TPA situation, however, also the large-consumer prices will rise and eventually exceed the equivalent oil products prices. This category of consumers will generally be capable of switching over to some other fuel (e.g. oil), causing the gas demand to fall.

In the existing situation the gas price does not reflect the supply and demand ratios of gas, but of oil products, while in particular to the customers of the LDCs (mainly small consumers and commercials) oil is no real alternative to gas. These users fully depend on gas (captive consumers). Moreover, in the current situation low oil prices lead to low revenues for the gas producers. So they get no incentives to raise production, which may bring about a scarcity of gas. This may jeopardise the security of supply. The right market price incentive is inherent in a TPA system, where the gas

price will balance supply and demand. That's why TPA is to be preferred also for reasons of continuity of supply.
Of course, this system will work properly only if the demand side is sufficiently strong and is capable of tuning in to the needs of the supply side, in particular with regard to long-term commitments. It is in this particular area that LDCs may play an important role.

4. Position of LDCs.

LDCs buy large volumes of gas for their multitudinous, mostly small, consumers. Further, they need high level supply security, so they are in a position and willing to enter into long-term contracts for large volumes of gas. In the Netherlands the LDCs are organised in an association (VEGIN) negotiating with Gasunie on the gas price on behalf of all LDCs. The negotiations relate to some 20 billion m^3/year. So LDCs may, jointly if relevant, occupy a strong position in the market.
To this end it will be necessary, by the way, that not only transmission, but also all other services that are now linked up with transmission (load balancing, storage, blending), become available under the TPA scheme as unbundled services.

5. Implementation problems surmountable

Evidently, the introduction of TPA is a major change, giving rise to a number of technical, economic and juridical problems. We are convinced that it will be possible to overcome these problems and that a minimum of regulation will be needed.

6. Substantial preventive effect

We expect that the introduction of TPA will act highly preventive. As soon as TPA will become a reality, all market parties will include this option in their commercial policies, which will greatly reduce the actual utilization of TPA.