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IOGP comments on the preliminary report for the Quo Vadis study

10 July 2017

By email to: ENER-B2-GAS-TEAM@ec.europa.eu

Dear Madam, Sir,

IOGP welcomes the invitation to provide actionable comments on the preliminary report for the Quo Vadis study. We would like to make the following comments, which hopefully will be useful for the next phase of the study, and welcome further stakeholder engagement opportunities on this matter.

What is the problem?

The objective of the study is to identify shortcomings and limitations of the current EU regulatory framework and subsequently to propose options to overcome these potential shortcomings.

Suggested action: IOGP believe it would be important for the study to clearly identify what is the problem, considering that implementation of the EU regulatory framework in the Member States is still an ongoing activity.

We acknowledge that there are still problems in certain Member States but those could be caused by non-compliance with the existing EU rules, or could be solved within the EU regulatory framework. The fact that the gas market is functioning rather well in the NW region of the EU could be seen as an indication that there are no apparent major issues with the existing EU regulatory framework. The preliminary report is suggesting pan-European solutions although there are significant differences between the NW region and the CEE and SEE regions. Access to diverse supply sources is a given in the NW region, whereas in the CEE and SEE regions the main driver for the development of infrastructure is to provide access to new sources of gas. Also gas demand projections are different for each region. Given the significant differences, there may be more merit in a regional approach rather than in redesigning the rules for the whole EU.

Suggested action: We would be interested if this study could identify shortcomings which the existing EU regulatory framework cannot address, or identify regional problems and identify suggestions how those could be solved by making more effective use of the existing regulatory framework.

Review of assumptions

IOGP suggests to explicitly review the assumptions that are used in the study. As an example, we mention a few of the assumptions that we have derived from the preliminary report:

1. The reference scenario assumes that, despite the NC TAR implementation, cross-border tariffs will be equal to the current tariff structure and will still limit gas trading in the EU (p.26). This assumes that the NC TAR will have no impact on cross-border tariffs, which we do not find to be realistic. In particular the use of short-term multipliers <1 could mitigate issues in case cross-border tariffs are considered to be too high. Moreover the reference scenario assumes that cross-border tariffs are limiting trade, which does not appear to be the case in the NW region and can be challenged since eliminating cross-border prices would remove the incentive to trade.

   Suggested action: We suggest to review the assumptions in the reference scenario that the NC TAR has no impact and that cross-border tariffs are limiting trade.

2. The preliminary report assumes competitive retail conditions, therefore wholesale price decrease and flexibility increase will be transferred into end customer price (p.66). We note that the current EU regulatory framework is mainly focused at increased competition at the wholesale level and has not always resulted in a corresponding benefit at the retail level, in part because of regulated end-user prices. Also such regulated end-user prices limit competition at the wholesale level.

   Suggested action: We suggest that the Quo Vadis study considers means for increasing retail competition rather than assuming that competitive retail conditions exist.

3. The study assumes stable domestic exit tariffs and unchanged TSO revenue. These assumptions mean that all changes to transmission tariffs are accumulated on the entry charges.

   Suggested action: We suggest to also include in the study the effect of changes in exit charges and different entry/exit split combinations.

4. The study assumes that entry tariffs are only partially passed on through to wholesale market prices. This is the only rationale for removing cross-border transmission tariffs and allocating these costs to entry points. However, in case additional entry costs are allocated to the marginal supplier, the impact to the market of increased wholesale prices could exceed the additional entry costs. This seems to be one of the drivers of the proposal for the Italian liquidity corridor. Please refer to the attachment for an illustration of the potential impact of entry tariffs on wholesale market prices.

   Suggested action: We suggest to carefully review the assumptions on the impact of entry tariffs on wholesale market prices.

5. We understand the study has assumed stable gas demand as well as stable supply sources and routes. However, removing price spreads between markets could have an impact on supply and demand. In particular it could drive changes to supply routes or utilization of LNG terminals. We also note that there are regional differences between the NW region and the CEE and SEE regions, and that the above assumptions seem to reflect the NW region only.

   Suggested action: We suggest to review the assumptions on elasticity of demand and supply.

6. In the alternative scenarios cross-border tariffs are removed and consequently it will not be possible to provide the right signals for market based investments. The recently adopted incremental capacity process of the NC CAM, which uses an economic test to justify and underpin new investments, will become useless. The study assumes that investments will be the result of a central planning process and should take into account the consequences of a less efficient process to trigger investments.

   Suggested action: We suggest to review the assumptions for investment planning

<u>Alternative regulatory scenarios</u>
Out of the selected alternative regulatory scenarios we question the feasibility of the 4th scenario *LTC gas delivered at EU border* as this raises complex issues on the legal grounds to force amendment of existing supply contracts between private commercial entities.

We agree with the assessment that the additional considered scenarios are not selected as alternative scenarios.

Suggested action: We suggest to remove the 4th alternative scenario.

<u>Final comments</u>

- The preliminary report mentions several times that the EU is supplied by a limited number of LNG and pipeline suppliers. This might give the wrong impression that the number of suppliers is diminishing. We would like to note that there are several potential new suppliers: US LNG is a proven new source of supply involving a wide range of companies. Additionally the Eastern Mediterranean is developing into a significant new area of supply and the potential for LNG from East Africa is significant. However, the EU should take all necessary steps to ensure the most effective utilization of indigenous resources and resources in the EEA.

- The study assumes specific future behaviors from different market parties suggesting, for example, that all mid streamers will not renew their long-term contracts and that all producers will keep them. This is an over simplistic representation. The reality is that every company will make their own assessment of the kind of contracts which they will need in their portfolio and the balance between short term, medium and long term contracts will depend on several factors including the company's strategy, future demand and supply outlook, availability of liquid hubs to trade on.

- The revenue from existing capacity LTC will disappear when cross-border tariffs are set to zero. The study assumes that this loss of revenue to the TSOs will be compensated. This raises issues why other network users should face additional charges while the holders of capacity LTC maintain their capacity rights.

- The comments on TPA exemptions for new infrastructure (p.6 and p.19) seem to relate to transmission infrastructure based on the reference to the NC CAM rules. However, for LNG terminals and gas storages we believe the TPA rules could be relaxed in regions where the market functions adequately and infrastructure investments have been replicated.

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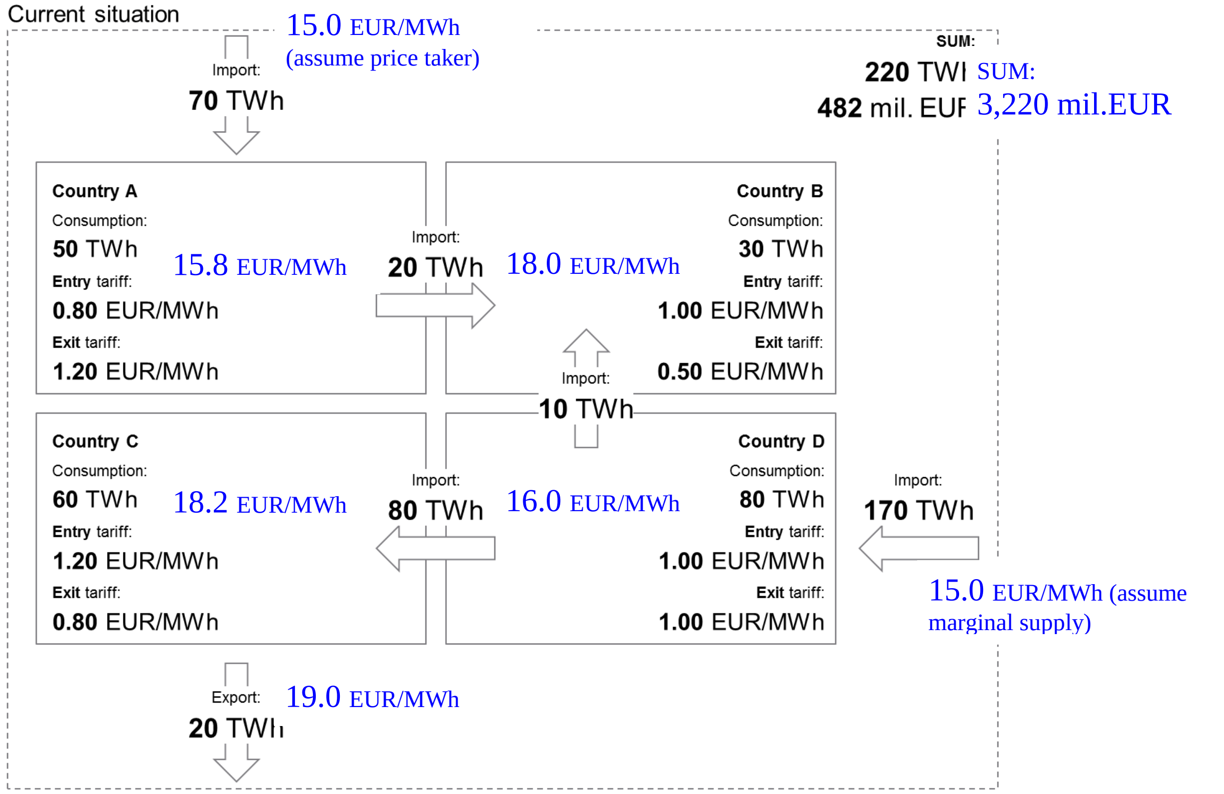
Attachment

As an illustration we have added pro-forma wholesale market prices to the diagrams on pages 46 and 47 of the preliminary report. This example shows that the trading zone merger reduces overall welfare by 3,486 – 3,220 = 266 mil.EUR or 55% of total transmission charges.

Current situation



Trading zone merger