

5th October 2001

European Energy Infrastructure Initiative

GTE Draft Position

General Comments

In the last three decades the geography of the West European gas industry has changed considerably. Thanks to the dynamic development of the market the European transportation infrastructure today extends from the North Sea to the Mediterranean and from the Atlantic Ocean to Central Europe connecting Europe with the large deposits in Algeria, Norway and Russia. Gas demand in Europe as well as its dependency on imports and especially also new sources is expected to grow considerably in the future.

Recent experiences in the highly regulated US energy industry indicate that the regulatory approaches applied cannot adequately cope with growing demand, system development or with the need to replace installations and, more generally, do not offer an overall incentive for the industry to invest. These imperfections are mainly attributable to a lack of response to the dynamics of market developments in the static approach for regulation. Indeed, a narrow focus of regulation on reducing or constraining prices may not serve the long term interests of customers if it undermined new investments.

It is against this background that GTE welcomes the European infrastructure initiative showing the European Commission's awareness of the respective issues. In the light of the existing dynamics of the energy industry and especially with gas expected to be the highest growth energy, GTE would stress the importance of the need for a stable and clear institutional framework which will provide incentives and reward for investment. However, different approaches are concernable for the design of such institutional framework and GTE is not clear about further implications once the European Commission will have met the stated objectives of identifying potential „gaps“ and „bottlenecks“ in the European electricity and gas networks. Nor is it clear whether a decision on how to design the institutional framework has already been taken.

GTE would be seriously concerned if the solution favoured by the Commission were a regulatory regime with central investment planning, thus assuming that a central authority might

have better and more profound knowledge about the development of the market and the behaviour of market players than those that are taking their decisions on commercial grounds. It is however widely accepted and shown by experience that such co-ordination by exclusion of the „invisible hand“ leads to negative or even counterproductive effects on the overall efficiency of the economy as well as on public welfare. Against this background GTE welcomes the clarifications received from the European Commission that it cannot and does not want to solve all the problems for the industry through centralised planning.

As a matter of fact the existing European gas grid has not been centrally planned but has been built up on a commercial basis primarily driven by market forces to match supply and demand. The development of the European gas grid from the Seventies up to today underlines the ability of the European TSOs to build, operate and extend the European grid with the consumer as the focal point.

The gas transportation business by its very nature has to take a long term perspective and long term contracts play an important role in matching the risks involved. In the course of liberalisation network owners are more and more faced with an increasing number of network users that are optimising their individual supply portfolios and thus are taking decisions independently on how to supply new and existing end customers. This tendency towards short term orientation requires an adaptation of the capacity planning process by the TSOs who still need to take the long term perspective given the scale and nature of infrastructure investment.

GTE nevertheless is convinced that markets can provide the right incentives to foster stable growth provided a favourable climate for investment is established. The role and the responsibility of various industry players, including the transmission system operators in ensuring overall security of supply needs to be reviewed:

- Network owners are facing new challenges as regards capacity planning. Due to the shorter planning horizons of network users capacity planning is becoming more and more complex and network owners will have to adapt their capacity planning procedures in order to gain reliable information where and when new investment is necessary and thus to adjust to the new environment.
- Network users will need to be incentivised to reveal their real priorities and to avoid opportunistic behaviour as regards the provision of necessary information to the network owner while having in mind that part of this information is strategic and thus commercially sensitive.

- Regulatory frameworks will have to cope with the dynamics of the energy industry as well as the need for a stable investment framework. As practical experience shows there is a trade-off between the perception of lower prices due to liberalisation and the incentive to invest in new infrastructure or to replace existing facilities. As a consequence of liberalisation the overall risk for network owners is potentially increasing, threatening a deterioration in investment or increasing costs to network users. Creating the right climate for both investment and efficiency is therefore essential.
- With increasing uncertainties due to liberalisation more incentives to invest will be necessary. GTE considers as essential that the legal or regulatory regime does not hamper the possibility for long term transportation contracts.

Since many of the aspects that are dealt with in the questionnaire can only be answered by its members individually GTE has distributed the questionnaire to member companies. From GTE as the association of transmission system operators in Europe, the following responses however can be made.

Current capacity situation and forecasts for the future

1. General level of availability and quality of gas supply and transportation infrastructure from a national/regional perspective and at European level. How is this expected to develop over time in function of demand and supply of gas?

In addition to the considerations presented above wherever the introduction of natural gas was commercially feasible new capacity has been built and it would not appear that any important links are missing. New links could however be desirable for reasons of diversification and some will be necessary in order to cope with the increase of gas demand. In cases of sustained price differentials between regions, new capacity will be required to reduce through arbitration price differentials unreasonably in excess of transportation costs. Historically the technical security of supply has a good track record from the national and regional perspective as well as at the European level. GTE does not expect a major change in the attitude of TSOs to accommodate market requirements as far as the availability and quality of gas transportation infrastructure is concerned provided that the regulatory framework does not lead to an unfavourable investment climate.

2. Which demand and supply scenarios/assumptions are used as a basis for infrastructure planning and which pressures do these scenarios create on infrastructure, in particular with regard to interconnectors between networks?

TSOs base their infrastructure planning on best available information. In future TSOs capacity decisions will have to rely increasingly on market information produced by shippers and TSOs will need to adapt their capacity planning procedures in order to adjust to the new situation.

3. Specific infrastructural issues identified (bottlenecks, lack of infrastructure etc)

From GTE's perspective it would not appear that any important bottlenecks or lack of infrastructure can be identified at the moment. It is important to note that due to the high degree of import dependency of individual Member States as well as the European Union, much interconnection capacity already exists. Approximately 60 % of the gas consumed in Europe crosses at least one border and indications about the availability of capacity at cross border nodal points can be taken from the GTE map on the internet. It is however important to note that due to the expected market growth and due to the increasing import dependency major new infrastructure will be necessary in future.

4&5. New capacity enhancements, connections and interconnectors needed? Which major new gas infrastructure projects or enhancements of existing infrastructure are planned?

Reference is made to the individual answers of GTE members.

Efficient use of infrastructure

6. Are there ways in which existing infrastructure could be used more efficiently and available capacity be enhanced relatively easy through technical improvements and reinforcements?

With respect to capacity enhancements there are a variety of different measures from additional power in existing compressor stations, new compressor stations, partial looping of lines up to the construction of new lines. The measures actually taken by a TSO are subject to commercial investment optimisation taking into account, amongst other things, the expected medium and long term market potential, the characteristics of the existing infrastructure and the resulting financial implications.

7. Which market based instruments e.g. with regard to allocation of scarce capacity should be applied to manage and alleviate congestion?

Provided that the regulatory environment is investment friendly and the demand for additional capacity is sustainable, scarcity of capacity is only a timing problem until new investment becomes operational. Clearly it is in the interests of everyone that such timing gaps are minimised by improved capacity planning and a favourable investment climate. Such gaps may be bridged by applying non-discriminatory principles for the primary allocation of scarce capacity as e.g. first come-first served or in relevant markets auctions. Most TSOs have already

implemented respective procedures. Moreover capacity rights could also be traded on secondary markets.

Transparency and planning assumptions regarding infrastructure investments

8. Is infrastructure development based on agreed security of supply standards?

Currently, in some countries network users take the responsibility for determining security of supply standards whereas in other Member States security of supply standards are subject to legislation, licence conditions or approval by authorities. Generally it is on the basis of these security of supply standards that TSOs guarantee technical security of supply whereas the suppliers/shippers take the supply security obligations. GTE however considers that the role of the different industry players with respect to meeting security of supply standards, and their determination, needs to be reviewed against the background of liberalisation (see GTE Position Paper dated 15 June 2001).

9. Which definitions would be relevant and what level of transparency would be reasonable with regard to available capacities? Which criteria for technical operating standards should be applied and which output standards with regard to security of supply should be applied?

The main principles are described in the Capacity and Congestion Management Report provided by GTE for the IV. Regulatory Forum in Madrid.

10. Which level of transparency and exchange of information with regard to infrastructure development and investments and network operation would be appropriate among network operators and which confidentiality issues would legitimately merit protection?

Information on infrastructure development and investment may be sensitive issues for TSOs, at least in the early project phase, since they are part of their business plans. This is all the more important in the context of existing or potential pipeline competition due to the freedom to build pipelines.

11. How are infrastructure and investment needs being defined and on what basis are investment programmes agreed? Which role does industry play and which role do public authorities play?

The freedom to build pipelines and settings by authorities should create the optimal investment climate and thus reduce constraints (technically, economically, procedural and environmentally) as much as possible. In a more regulated context, it is crucial that the authorities ensure a stable and consistent framework within which companies take their investment and commercial decisions.

12. Which minimum level of infrastructure and interconnector capacity between networks should be required for a well functioning internal market?

No general answer can be given. The minimum level of infrastructure and interconnector capacity between networks should be based on in depth and reliable analysis of market demand for the respective capacities (see also Q.16). Interconnection capacity is also relevant to wider security of supply considerations, and may help to foster competition between different sources of gas supply (see also Q 15).

13. Which forward-looking transparency and consultation requirements should a governance framework aimed at defining and ensuring sufficient infrastructure capacity be based upon?

As has been pointed out above TSOs will have to adjust their capacity planning tools to the new dynamics of the energy market. These will have to reflect that the responsibility for serving markets is shifting from one or only a few integrated companies to an increasing number of independent marketers and that the responsibility for meeting security of supply standards may also shift to network users. Network users, TSOs and/or public authorities should define the level of security of supply that they consider appropriate for customers' needs. The respective responsibilities need to be redefined (see GTE Position Paper dated 15 June 2001). Furthermore, there needs to be clarity concerning who is responsible for determining appropriate security of supply standards, and who is responsible for meeting them, recognising that there are several different facets which contribute to overall supply security, such as transportation infrastructure and access to gas supplies for the long term and, availability of storage for the short term security of supply.

The respective roles of industry and public authorities

14. Which instruments are (or should be) available at Member State level to ensure necessary reinforcements being undertaken?

To ensure that necessary reinforcements may be undertaken the freedom to build pipelines should be implemented as is already the case in some Member States. Moreover a stable and predictable investment climate is essential to encourage timely investment.

15. Which role should be industry play and which role should Member States and the Community play in ensuring provision of sufficient infrastructure and a stable regulatory framework providing long-term investment incentives?

TSOs should adapt their capacity planning tools whereas network users and end-customers should redefine their responsibility for security of supply. Moreover, they need to become more involved in the investment planning process, particularly in consideration of their willingness to pay for additional transportation flexibility in excess of minimum security of supply levels.

Member States should provide a consistent, transparent and predictable institutional framework with clearly defined responsibilities of stakeholders in order to exclude opportunistic behaviour and encourage security of supply.

16. Should long-term infrastructure planning be based on commonly agreed planning assumptions with regard to national circumstances?

Minimum common planning principles could be beneficial for the functioning of the internal market. Commonly agreed detailed planning assumptions may not be appropriate for various reasons as they could not reflect the specific conditions in individual Member States where local differences have to be taken into account as peak demand, storage availability etc.

17. Can co-operation between the public and private sector with regard to European energy infrastructure be improved? If so, how?

Regarding infrastructure reinforcements, GTE has a clear preference for investment made by the companies and public finance should not create unjustified market distortions. The final decisions about infrastructure development should be made by the industry.

Identifying European priorities with regard to gas and electricity infrastructure

18. Which should be the key priorities with regard to energy infrastructure of national importance and of common European interest?

Key priority should be the monitoring of regulatory regimes as regards their effect on the overall investment level. If a regulatory regime leads to a gap between the existing and required capacities it should be adjusted to allow the industry to take responsibility for new investments. Thus regulatory regimes should then increase the attractiveness of new investment on commercial grounds. The need to ensure security of supply as markets liberalise is paramount.

19. Which neighbouring regions are of particular strategic importance with regard to energy supply and infrastructure to the EU? In relation to revising the TEN guidelines, which should be the priorities with regard to the identification of priority project?

Russia, Central Asia, North Africa and the Middle East. Priority projects in the framework of TEN should be the investment in future supply routes. With respect to the effectiveness of such measures it is essential that the possibility to conclude long term take or pay contracts as well as long term transportation contracts is maintained. Another aspect is the integration of EU Candidate Countries where new interconnections are necessary for reasons of diversification of supply. Against this background GTE believes that the TEN procedures should be reviewed.