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# **7<sup>th</sup> EU-Russia Gas Advisory Council Meeting**

Brussels, 14 June 2013

## **Work Stream 2 Internal Market: Progress report**

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Co-chairs WS2

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# Outline

**Overview of Ongoing WS2 Activities**

**Progress Made since the last GAC in January**

**Future Work Areas and Next Steps**



## Overview of Ongoing WS2 Activities



## Issues discussed since January 2013

<b>Subject Area</b>	<b>Status</b>
<b>Glossary of Gas Market Terms</b>	Ongoing in-depth discussion
<b>Framework Guidelines and Network Codes</b>	Regular ongoing updates
<b>Russian Pipeline Access Regime</b>	Preliminary Discussion
<b>Incremental Capacity</b>	Ongoing in-depth discussion
<b>Future of Delivery Points</b>	Ongoing in-depth discussion
<b>Answers to Questions posed by January GAC</b>	Done 4



## **Progress Made**



## **Glossary of Gas Market Terms**



# Glossary of Gas Market Terms

- What it is: Living reference document with explanations/definitions of common gas market terms
- Recent activity
  - categorization of terms in 3 groups (agreed terms, nearly agreed terms, terms with no common understanding)
  - explanations to open questions
  - addition of legal references and other sources
  - proposals for new terms to be added ('trade' vs. 'delivery', etc.)



**Glossary:** not only an explanatory paper, but an ongoing process aimed at increasing transparency & narrowing the zone of possible multiple interpretations of the key terms of the Third Energy Package

**Term & definitions finally settled & mutually agreed in substance**

**GLOSSARY = Non-legally binding explanatory doc't on TEP terms (\*)**

(\*) another title to "Explanatory Note on TEP" to be found (Minutes WS2 28.01.2013 meeting)

**Not yet settled & not yet mutually agreed, but still in the process of clarification**

**Finally not settled & not mutually agreed**

**To GAC for decision?**

Reports to WS2 & to GAC meetings

To politicians?  
To in-depth academic debate?  
To ...???

**TEP terms & definitions**

New terms:  
RUS & EU ongoing inputs

**Ongoing process of updating Glossary**

**Process of further development of Third Energy Package (GTM + FGs + NCs + updates...)** 8





## Framework Guidelines and Network Codes



# Framework Guidelines and Network Codes

- Regular updates on current status of framework guidelines and network codes
  - scope of FGs/NCs
  - explanation of content
  - possibility to raise concerns
  - timing
  - next steps



# Framework Guidelines and Network Codes

- Since January regular updates were provided particularly on
  - CAM NC
  - IO NC
  - Tariffs FG



## **Russian Pipeline Access Regime**



## Russian Pipeline Access Regime

- Presentation of key facts and figures of Russia's Unified Gas Supply System
- Preliminary exchange of views on existing rules and regulations regarding independent pipeline access in Russia
- Possible follow-up of this issue in the second half of 2013



## **Incremental Capacity**



## Incremental Capacity

- Key question raised in the context of WS2 with respect to incremental capacity:
  - which regulatory procedures are needed to develop new capacity without exemption from the 3<sup>rd</sup> Package if the market requires it?
- How this question was addressed so far:
  - In-depth discussion of CEER work on Incremental capacity (*CEER Blueprint on Incremental Capacity*)
  - Russian participation at CEER workshop on incremental capacity on 3 June including a follow-up discussion at WS2 on 4 June



## Incremental Capacity

- Possible way forward with incremental capacity in WS2:
  - Proposal from the Russian side to continue the discussion through a hypothetical case study – The ‘Sweet Dream’ Project
  - Rationale for the case study: use a case with maximum complexity to be sure to cover all relevant issues (particularly those which are not covered by the CEER Blueprint on Incremental Capacity)
  - Current Status: the proposal is being evaluated; meanwhile the Russian side was invited to participate in EU consultation process to raise awareness of its concerns





## **Future of Delivery Points**



## Future of Delivery Points

- Key question/discussion: in which EU Member States will delivery points continue/ceize to exist in addition to the VTP?
- Currently, WS2 attempts to establish an overview of the situation in selected EU Member States
- Data gathering process is ongoing



## Future of Delivery Points – Results so far

EU MS	Yes, DP will continue to exist	No, DP will NOT continue to exist	Do not know yet...	
			... but will know at ...	... and do not know when will know
1. Italy	x			
2. Greece	x			
3. Hungary	x			
4. Czech Republic	x			
5. Slovenia				x
6.				
.....				



## **Answers to Questions posed by January GAC**



## **Six questions posed in para 14 of the conclusions of the 29.01.2013 GAC meeting - & five WS2 answers**

- 1. Can the delivery points in the existing contracts be preserved?**
- 2. Can the assurance be provided of sufficient capacity for delivery under existing supply contracts?**
- 3. Is the gas dispatching service (GDS) compatible with the Third Package? *(plus additional view from WS3 RUS Co-Chair)***
- 4. Are Coordinated Open Seasons compatible with the Third Package?**
- 5. What will be the investment regime and regulatory treatment for incremental and new capacity?**
- 6. Whether new Russian cross-border transportation projects can be considered within the PCI framework and whether a PCI treatment could be awarded to those Russian projects that will be considered PMI? *(Q6 is from WS3 agenda – not for WS2)***



## Q1. Can the delivery points in the existing contracts be preserved? EU View

- In principle, EU law says YES
- Delivery points in existing long-term contracts can be preserved in all EU MS
- Specific case for delivery points in contracts which have been concluded on the basis of commercial hub services
- Detailed explanations and answer on next slides



## Q1. Can the delivery points in the existing contracts be preserved? EU View

Yes, according to the CAM NC, the revised sunset clause allows for existing contracts to retain their delivery points (at the flange) for their duration. Thus, from an EU perspective the answer is yes in principle. Also the current national laws and regulations in EU Member States in principle allow the retention of the delivery points (at the flange) for their duration.

However, a distinction needs to be made between two types of existing contracts:

1.(long-term) contracts for the supply and delivery of gas directly concluded between (an upstream and a downstream) shippers (so-called "shipper-to-shipper transfers" which are executed by respective nominations of the upstream shipper (seller) and downstream shipper (buyer) with the TSOs at a given IP) and

2.(short- to medium-term) contracts which have been concluded on the basis of commercial hub services between a (upstream or downstream) shipper and a "virtual/paper trader" and/or between two "virtual/paper traders".

Regarding existing contracts as mentioned in point 2.) some national laws in Member States (especially Austria) put in place in conjunction with implementing entry-exit systems do not allow delivery points in these existing contracts to be preserved.



# Q1. Can the delivery points in the existing contracts be preserved? EU View

## Austrian case

1. Delivery points in existing long-term GSA can be preserved
2. Delivery points in existing (short- to medium-term) contracts which have been concluded on the basis of commercial hub services (CEGH) have to be transferred to the VTP

## Section 170 para 24 of the Austrian Natural Gas Act 2011

*“The place of execution of contracts in existence on 1 January 2013 for commercial hub services and the trades connected thereto shall be transferred to the virtual trading point in the market area concerned, and the corresponding nominations shall be made with the operator of such virtual trading point.”*

## Reasoning

- Introduction of the entry-exit system in Austria on 1 January 2013
- CEGH stopped to offer commercial hub services at Baumgarten (and other IPs)
- Execution of commercial hub services thus became impossible (i.e. Central Matching Agent)
- CEGH acts as operator of the VTP as of 1 January 2013





# RUS/GG experts comment on EU view on Q1 (1)

- Para 1 – yes (!):
  - ‘*pacta sunt servanda*’ principle (TEP is for new, not for existing contracts)
- Para 2 – clear dividing line between two types of existing contracts (if DP can stay only in type (1) contracts) =>
  - Will depend on result of discussion on “trade” vs. “delivery” (see: Glossary)
  - Whether existing contract of type (2) were possible before TEP?
- Para 2, 3 – questions & concerns:
  - RUS/GG asked EU to provide clear answers which MS (will / intend to / has) deviate(d) from this rule **(F1)**
  - In case of such deviation (like in Austria – to all or just type (2) contracts?):
    - Abolishment of statement in para 1?
    - Logical, legal, economic consequences



# Figure 1. How to finalize debate on “delivery points”?

RUS/GG experts proposal to the EU side to fill the table prior to next round of Consultations/WS2 GAC meeting proposed to be held prior to 14/06/2013  
 GAC meeting (on June 4, 2013, in Brussels)

EU & EU MS	Yes, DP are allowed	No, DP are NOT allowed	Do not know yet...	
			... but will know at ...	... and do not know when will know
EU as a whole, incl.:	(X) (?)			
1. Austria		(X) (?)		
2. Italy	X			
3. Greece	X			
4. Hungary	X			
5. Czech Republic	X			
6. Slovenia				X
.....				

**Q: Whether MSs with different DP regimes within one merged market zone/area possible ?**



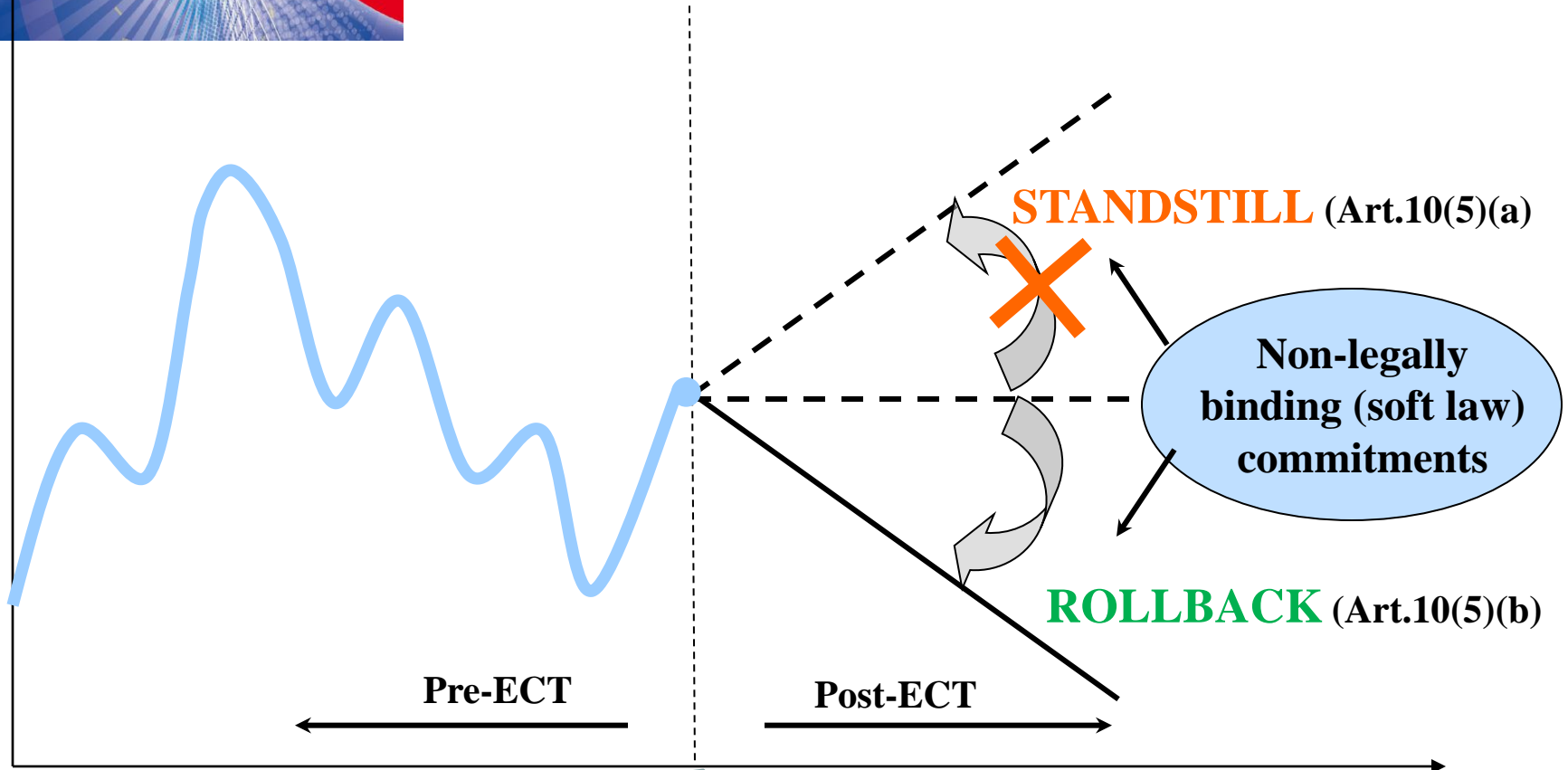
# RUS/GG experts comment on EU view on Q1 (2): possible consequences of deviation from EU rules by individual EU MSs

- Logical:
  - Common internal EU market vs. different rules in individual MSs, even for transition period
- Legal:
  - Superiority of domestic vs. EU law
  - Amended “existing” contracts will/might become “new” => obligatory bundling => economic consequences => EU promised to investigate
  - Violation of ECT rules? (EU & EU MSs has ratified ECT):
    - Art.10.1: “each CP **shall** observe any obligations it has entered into with an Investor or an Investment of an Investor of any other CP” (*hard law*)
    - Art.10.5: *standstill & rollback* provisions (*soft law*) **(F2)**
- Economic:
  - Risk of contractual mismatches in individual MSs **(F3)**
  - Compensation for losses: “prompt, adequate and effective” (ECT Art.12-13)

DISCRIMINATIONS FOR INVESTMENTS / INVESTORS



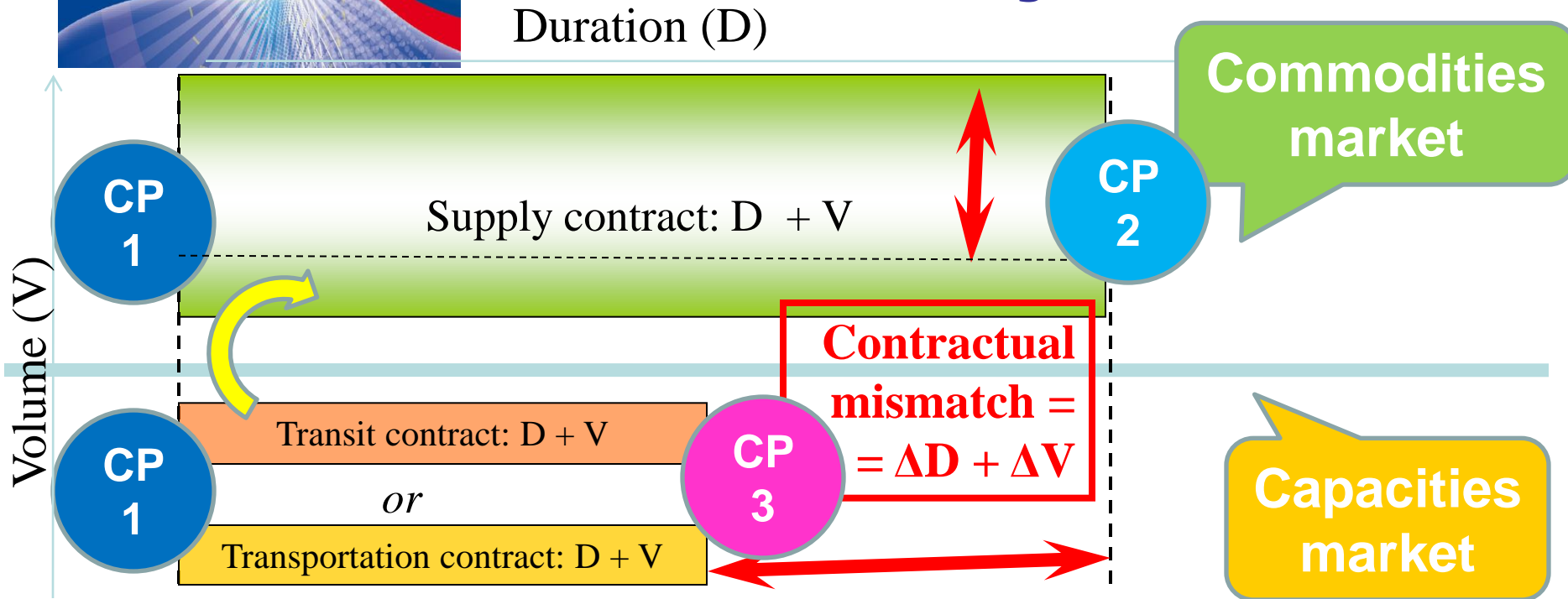
## Figure 2. ECT INVESTMENT REGIME: STANDSTILL & ROLLBACK PROVISIONS (ARTICLE 10(5) ECT)



Date of ECT ratification / provisional application by CP  
(RF-EU: within Dec.1994-April 1998 period)



## Figure 3. Contractual Mismatch Problem: major risk for contractual parties in unbundled gas market



**Contractual mismatch:** between duration/volumes (D/V) of long term supply/delivery contract (LTGEC; CP1-CP2) and transit/ transportation contract (CP1-CP3); the latter is integral part to fulfill the delivery contract => risk non-renewal transit/ transportation contract => risk non-fulfillment supply/delivery contract.

**Core issue:** guarantee of access to/creation of adequate transportation capacity for volume/duration of long term contracts



## **Q2. Can the assurance be provided of sufficient capacity for delivery under existing supply contracts?**

### **EU View**

- There is no absolute guarantee/assurance
- Work is underway to enhance the process
- So far there have not been any reported problems
- Detailed explanations and answers on next slides



## Q2. Can the assurance be provided of sufficient capacity for delivery under existing supply contracts?

### EU View

- **Regulatory Framework for network access:**
  - Network Code on Capacity Allocation Mechanism (of existing capacity)
  - Tariff Framework Guidelines
  - CMP
  - ➔ Assuring that capacity is available on a non-discriminatory, transparent and efficient basis according to the Regulation
- **But dynamic market environment with uncertainty in future supply and demand needs guidelines for infrastructure development**





## Q2. Can the assurance be provided of sufficient capacity for delivery under existing supply contracts?

### EU View

- **Ensuring efficient investment with market-driven processes**
- **Blueprint for incremental capacity**
  - Aim is to meet market demand for capacity while limiting the risk of stranded assets
- **Key principles:**
  - Clarity on when incremental capacity would be offered
  - Design of the investment procedure as consistent as possible with auctions used for existing long-term capacity
  - Strong cross-border coordination to ensure project design is consistent and fits the market's needs
  - Transparency on costs calculation and tariff setting
  - Decision to invest based on the results of an economic test, known in advance by network users





## **Q2. Can the assurance be provided of sufficient capacity for delivery under existing supply contracts?**

### **EU View**

According to the EU gas market model, capacity to transport gas has to be allocated in a transparent and non-discriminatory manner. At the same time, expiring capacity contracts have to be reallocated by the TSO in line with the CAM NC rules.

In case the capacity contract underlying a supply contract expires before the supply contract expires, the shipper has to participate in the CAM auction process to secure new capacity. In view of the Congestion Management rules entering into force this autumn and the general trend that gas pipelines are rarely physically congested, this should be possible.

In addition, work is underway to supplement the CAM NC with rules to allocate "incremental" capacity allowing shippers to bid even for capacity that is not yet built, effectively ensuring that sufficient capacity (for which there is market demand) is in place in the EU transmission system.



## RUS/GG experts comment on EU view on Q2

- Para 1-2: no such assurance can be provided since the auction mechanism of CAM NC does not *guarantee* that capacity requested by the shipper will be allocated to him in requested quantities and duration adequate to this shipper's obligations under his underlying supply contracts => risk of contractual mismatch despite best endeavours
- Para 3: see RUS/GG experts comment on item 5



## **Q3. Is the gas dispatching service compatible with the Third Package? EU View**

- Gas dispatching service could in theory be compatible depending on its design (i.e. whether it complies with the principles of the 3<sup>rd</sup> Package)
- Concrete proposals would need to be analyzed also in view of its associated potential costs and benefits
- Detailed answer on next slide



## **Q3. Is the gas dispatching service compatible with the Third Package? EU View**

There is no specific provision in the Third Package on the organizational aspects of the dispatch of gas. Regulation (EC) 715/2009 calls on TSOs to adopt common network operation tools through ENTSOG to ensure network coordination in normal and emergency conditions; the respective work is ongoing and reflects the framework established by the developed Network Codes. Therefore a centralized EU gas dispatching service could in principle be compatible with the Third Package. As presented so far, however, the GDS seems to include elements which may contradict the Third Package and Network Codes (which place emphasis upon market based mechanisms and network user choice) in particular in terms of the arrangements it foresees for capacity allocation and nomination.

Therefore the compatibility of the GDS with the Third Package needs to be analysed based on concrete descriptions and deliverables of such service and the underlying operational functioning thereof and also in view of the associated potential costs and benefits.



## RUS/GG experts comment on EU view on Q3

- Different interpretations of GDS possible =>
- At minimum (economic justification): coordination of TSOs to exclude contractual mismatch within (long-term long-distant large-scale) gas deliveries (**F3**) originated from non-EU & destined for EU customers located in a distant zone from external EU border => multiple cross-border crossings => to coordinate bundled products at IPs within chain of zones
- PRIZMA as a starting step in right direction?
- See WS3 RUS Co-chair comment on next slide



## WS3 RUS Co-chair comment on EU answer to Q3 (1)

- One of the main functions of GDS is ensuring the fundamental requirements of the 3<sup>rd</sup> Directive – to provide all market players with the possibility to buy and/or sell gas at any point of the network; and delivering it to consumer. That is why the fundamental aims of GDS are fully compatible with the Third Package.
- Some doubts were expressed by EU who recognized that “a centralized EU gas dispatching service could in principle be compatible with the Third Package”. However it seems to EU that “the GDS includes elements which may contradict the Third Package and Network Codes ... in particular in terms of the arrangements it foresees for capacity allocation and nomination”. As a result EU comes to conclusion that “...the compatibility of the GDS with the Third Package needs to be analysed based on concrete descriptions and deliverables of such service and the underlying operational functioning thereof and also in view of the associated potential costs and benefits”.





## WS3 RUS Co-chair comment on EU answer to Q3 (2)

- This opinion would be reasonable if one is selling some completed instrument which elements are fitted in such a way that nothing can be changed without significant risk of breaking the product as a whole. Actually we propose to develop this project together. In the frame of joint project all contradictions may be removed, costs and benefits identified and evaluated.
- Successful implementation of GDS will contribute to “Removal of all barriers for the integrated functioning and coordinated development of gas infrastructures and markets” – one of the goals declared in EU-Russia Energy Cooperation Roadmap until 2050.



## **Q4. Are Coordinated Open Seasons compatible with the Third Package? EU View**

- Yes
- Similar proposals in this direction are being discussed
- Detailed answer on next slide





## **Q4. Are Coordinated Open Seasons compatible with the Third Package? EU View**

The Third Package obliges TSOs to co-operate. Coordinated Open Seasons (COS), or the process of allocating capacity for possible new interconnection points/routes on the basis of a harmonized open season process among several adjacent national regulatory authorities and TSOs, are therefore compatible with the Third Package.

In fact the current work on "incremental capacity" as a possible amendment to the CAM NC foresees – besides allocation of additional capacity at existing interconnection points – the establishment of an open season mechanism very similar to the COS for more complex new interconnection points/routes.



## RUS/GG experts comment on EU view on Q4 (1)

- WS2/GAC has earlier supported coordinated OS as economically justified mechanism of developing new capacity which is compatible with TEP => we are glad that EU once again has confirmed this
- Initial RUS/GG proposals on EU-wide coordinated OS as universal mechanism of allocation existing, incremental & new capacity within 10YNDP will *not* work now *in full* - after CAM NC is in place **(F4)**...

**Figure 4. Open Season as Mechanism of Long-, Medium-, and Short-Term Allocation of Capacity**  
*(initial proposal of RUS/GG experts)*



**10YNDP + CAM FG/NC + CMP FG/NC**

*Market test for/Allocation of capacity via regular annual/bi-annual mechanism*

Based on results of informal RF-EU expert consultations on Energy Charter Protocol on Transit open issues in 2004-2007 (Art.8.4): continuity

**Long-term solution** (appr. Y5/7 forward) – to liquidate existing deficits & to prevent future deficits to appear

Opportunities to invest in capacity expansion

**Short-term solution** (approx. Y1-Y5/7) to deal with existing deficits

**Available Capacity**

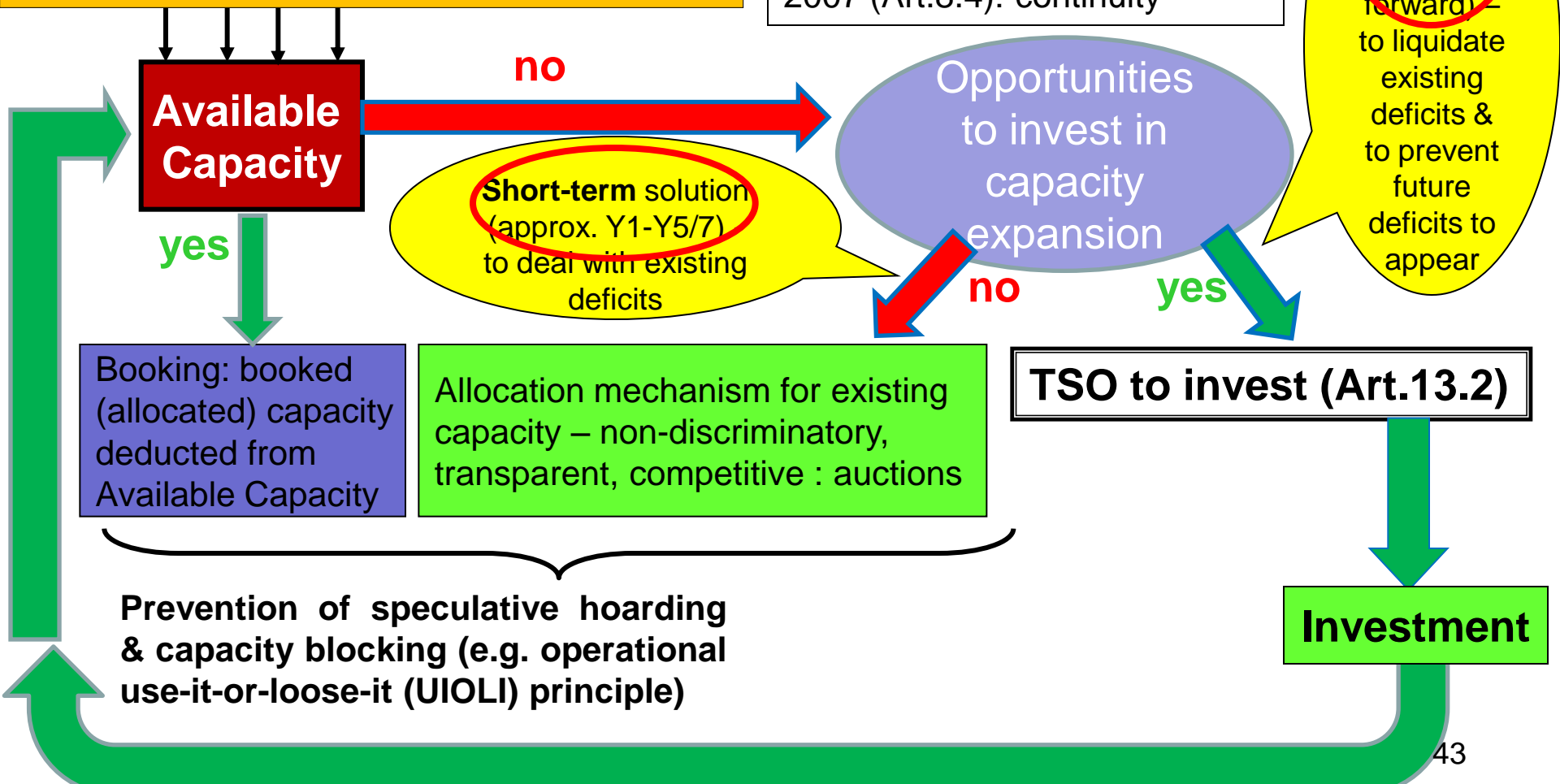
Booking: booked (allocated) capacity deducted from Available Capacity

Allocation mechanism for existing capacity – non-discriminatory, transparent, competitive : auctions

**TSO to invest (Art.13.2)**

**Investment**

Prevention of speculative hoarding & capacity blocking (e.g. operational use-it-or-loose-it (UIOLI) principle)

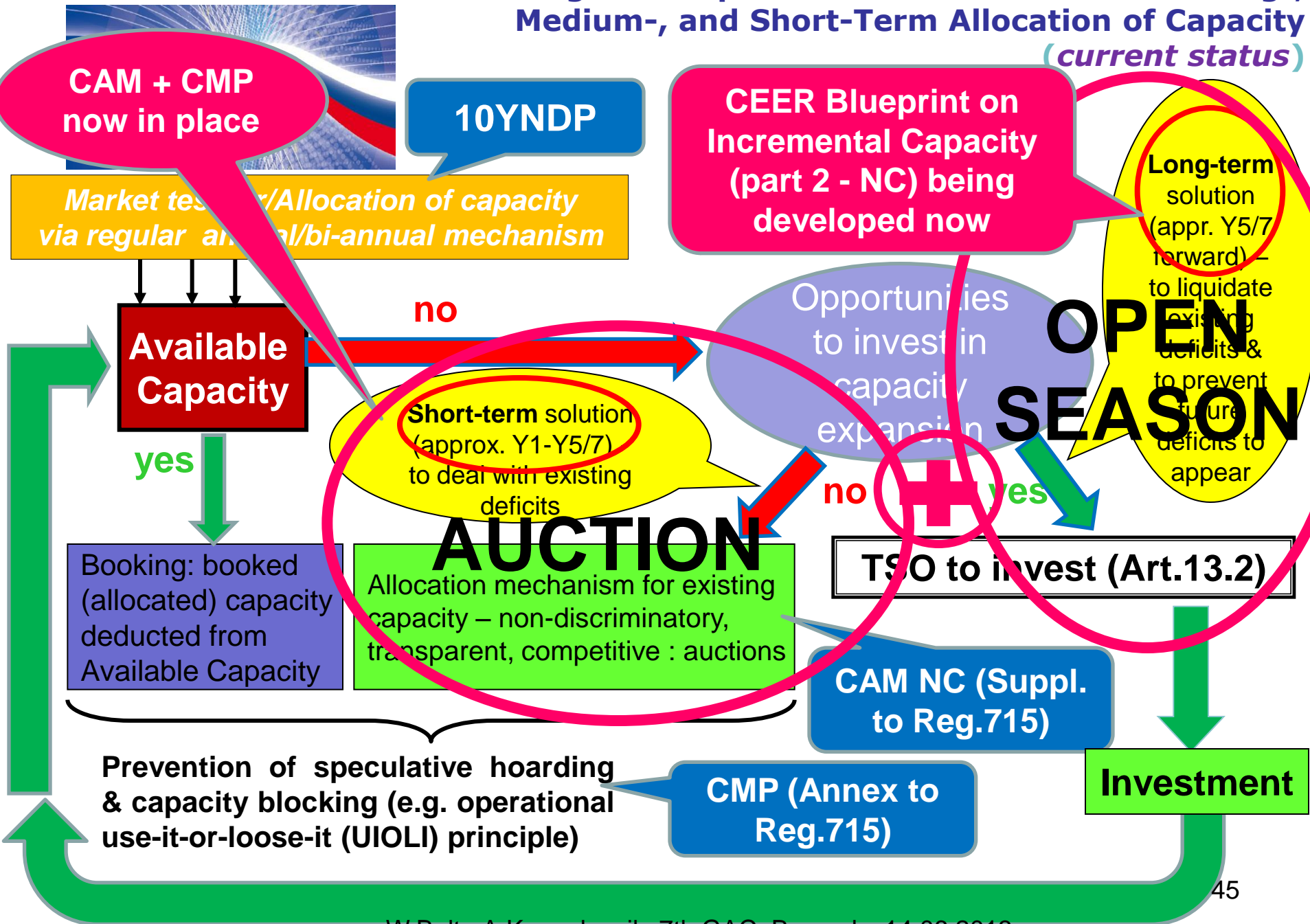




## RUS/GG experts comment on EU view on Q4 (2)

- ... but part of our proposal aimed at preventing capacity deficit to appear in economically justifiable future **(F5)** still can be used in (is compatible with) CEER Blueprint:
  - its “new capacity” section (03.06.2013 CEER W/shop),
  - best effective case for developing OS procedure today
  - will save time within limited time-frame for CEER Blueprint finalization
- GGPOS-2007 as a possible starting point for developing legally binding EU-wide coordinated OS:
  - “TSO” instead of “sponsor”, etc.
- Case study on Art.13.2 procedure (“TSO shall invest”) :
  - ‘Sweet Dream’ project **(F6)** & reasoning behind it & its joint implementation, but
  - limited EU time frame (till 30 Nov’2013) to develop a robust procedure is additional argument for cooperative efforts

**Figure 5. Open Season as Mechanism of Long-, Medium-, and Short-Term Allocation of Capacity**  
*(current status)*







## Figure 6. Proposed case study on Art.13.2 of Third Gas Directive ('Sweet Dream' Project map)



More details of this Proposed Case Study on Art.13.2 are available from presentations at Consultations / WS2 meetings of 22.03.2013 & 29.04.2013



## **Q5. What will be the investment regime and regulatory treatment for incremental and new capacity? EU View**

- The investment regime is currently being developed
- Detailed answer on next slide



## **Q5. What will be the investment regime and regulatory treatment for incremental and new capacity? EU View**

This new regime is in the process of being developed. The basis is the CEER Blueprint paper foreseeing auction-type capacity allocation for incremental capacity at existing interconnection points and an open-season-like approach for new points/routes.

The precise details are being developed now. The aim is to adopt amendments to the CAM NC via comitology, allowing for the first lot of incremental capacity to be offered at the annual capacity auctions in March 2017.





## **RUS/GG experts comment on EU view on Q5 (1)**

- We support development of incremental capacity rules (CEER Blueprint on Incremental Capacity, Ref: C13-GIF-06-03, 23.05.2013), which is something that RUS/GG has been proposing for over past 3 years of Consultations/WS2 process...
- ...but some concerns re substance, timing, format of implementation => direct effect on non-EU supplies (incl. RUS/GG) to EU

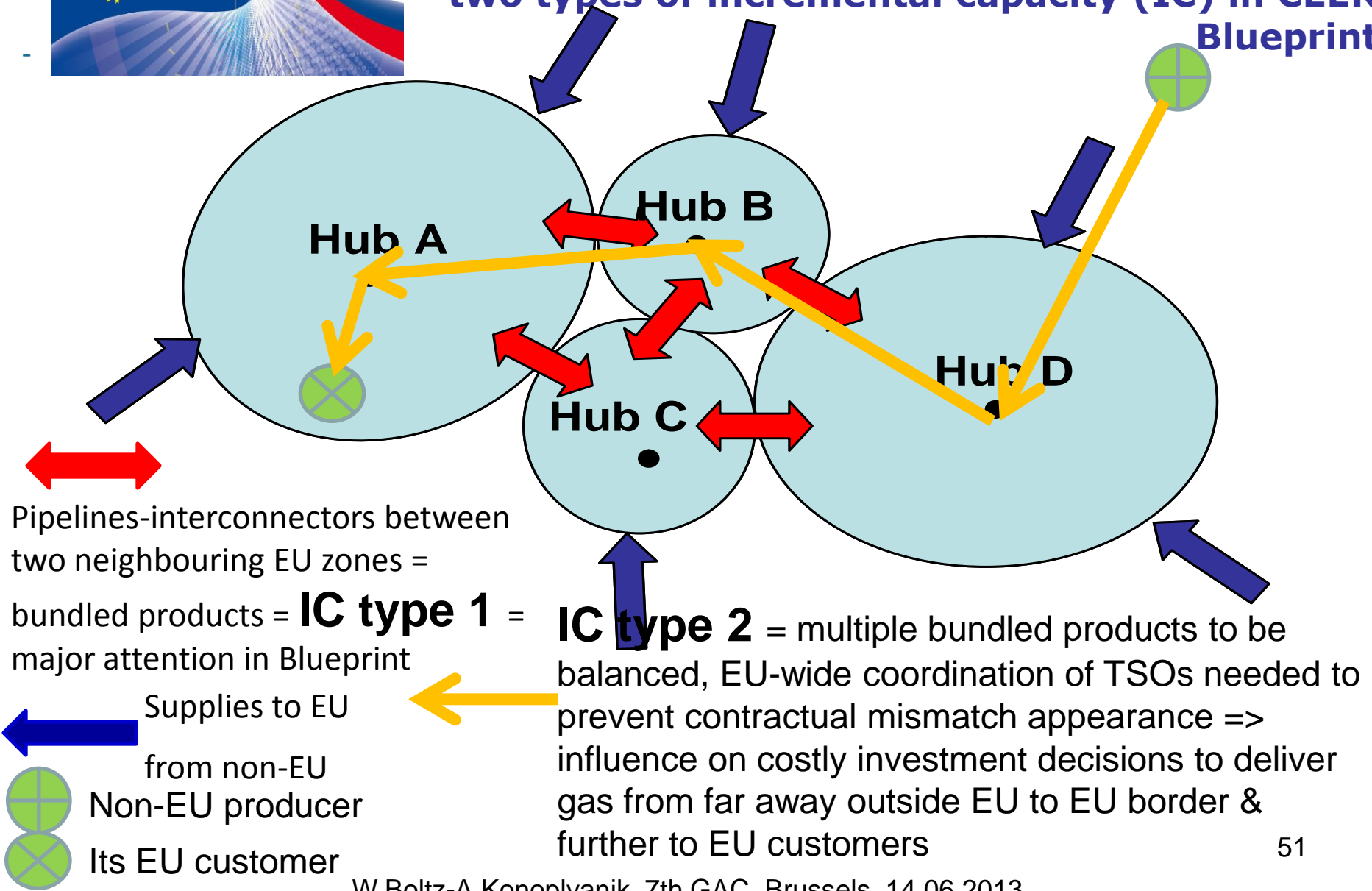


## RUS/GG experts comment on EU answer to Q5 (2)

- We support project financing approach in CEER Blueprint
- Economic test, but two different types of projects (**F7**) & tests:
  - **incremental capacity (IC)**: auction-type CAM NC procedure => TSO offer capacity to potential shippers (market players) in minor steps => supply-based approach => no guarantee for shipper that his request for capacity is covered in full => trade-oriented procedure well developed in CEER Blueprint
  - **new capacity (NC)**: OS-type procedure (totally different from CAM NC) => TSO to collect justified requests for capacity => TSO shall invest (Art.13.2) => OS shall be legally binding => demand-based approach => guarantee for shipper that his request for capacity is covered in full PLUS guarantee for TSO that development of new capacity is bankable (guarantee of CAPEX pay-back = capacity booking by shipper + “ship-or-pay” + UIOLI) => delivery-oriented procedure not yet fully developed in CEER Blueprint



**Figure 7. EU internal gas market architecture according to TEP (E-E zones with VTP/hubs) - & two types of incremental capacity (IC) in CEER Blueprint**





## RUS/GG experts comment on EU view on Q5 (3)

- Condensed timing CEER Blueprint finalization:
  - 03 June => 17 June => 30 November
- Best format of implementation of Blueprint (existing & incremental capacity = auctions, new capacity = OS):
  - Amending CAM NC? New NC on Investments?
- To coordinate CEER Blueprint with Tariffs Harmonization FG:
  - Timing CEER Blueprint & Tariffs FG very sharp
  - Tariffs FG => tariffs seems to be more costly & less predictable => disincentives development of new capacity:
    - Proposal for floating reference prices => shippers won't know tariffs over 1 year period => contradicts with project financing
    - Bundled products => shipper to pay both exit (as today) plus entry tariffs
- On balance, we welcome the work that CEER has undertaken on this, but remain concerned that insufficient time is being devoted to developing a robust approach



**Q6. Can new Russian cross-border transportation projects be considered within the PCI framework and could a PCI treatment be awarded to those Russian projects that will be considered PMI?**

***– Answer to be provided by WS3***



## **Future Areas of Work and Next Steps**



## Future Areas of Work

- Russian Market Issues, e.g.:
  - market development
  - pipeline access
  - export monopoly
- EU Market Issues, e.g.:
  - Incremental Capacity
  - Tariffs FG/NC
  - Other potential issues: interoperability, transit contracts, etc.



## Next WS2 Meeting

10 & 11 September 2013  
St. Petersburg, Russia



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