

ofgem



Ministry of Economic Affairs
and Climate Policy

Key elements of gas market opening

Workshop on gas market design – Session 1

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Brasília, 23 August 2018



*In energy and other markets, **the question of liberalisation has been high on the agenda** over recent decades.*

Different sectors and regions have experienced varying degrees of success and a number of models have emerged.

However, there are a few **fundamental questions that apply to all liberalisation programmes:**

- *How to identify and separate natural monopoly activities from those open to competition?*
- *How to regulate natural monopoly activities?*
- *How to allow competition to develop in areas open to competition where a dominant incumbent is present?*



In energy, **ownership and operation** of the networks is widely recognized as a **natural monopoly**.



Natural monopoly means competition is likely to be absent or at least inefficient and **regulation is required**.



Where vertically integrated incumbents are present, **separation of network activities from other activities (e.g. production, supply) is essential**.



In Europe, there are a range of models including **full ownership unbundling and independent transmission operation**.

*Monopoly activities require economic regulation to **protect customers/consumers from the adverse effects of companies having significant market power.***

Key principles include:

- *Third Party Access (TPA) to the networks based on transparent, non-discriminatory capacity allocation mechanisms and charging methodologies.*
- *Obligations to develop networks in an efficient and economic manner.*
- *Incentive based regime (e.g. price control) with rewards for outperformance and penalties for failure to meet required standards.*
- *Appropriate allocation of risk between companies and customers/consumers.*

There may be scope to introduce competition/contestability to some aspects of energy networks.

In areas of the industry that are open to competition, steps must be taken to **promote the development of competition, especially where dominant incumbents are present.**

TPA to the network is a necessary condition for competition to develop. TPA should also be considered for storage, LNG and cross-border pipelines.

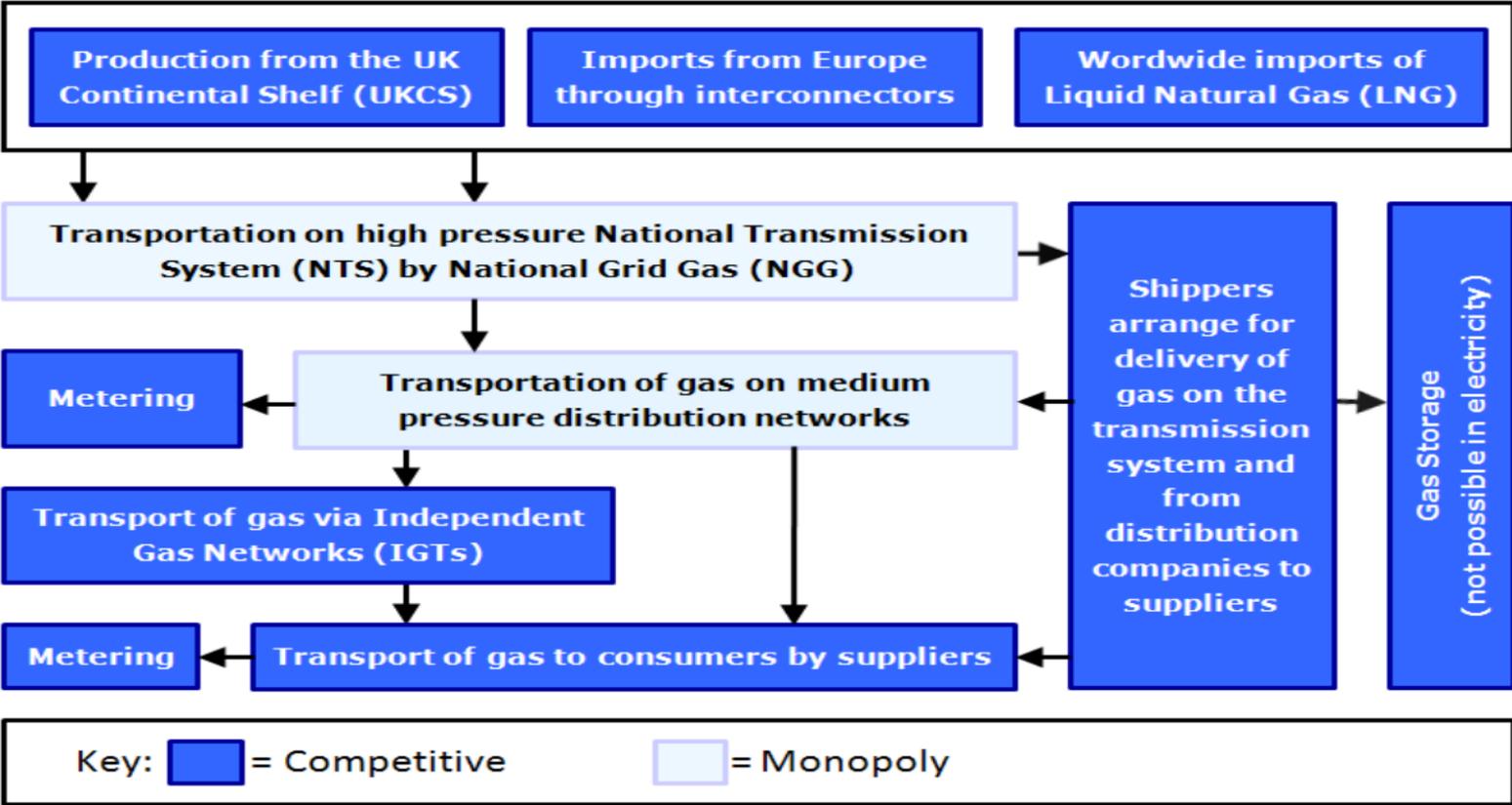


Clears roles and responsibilities for different players are essential.

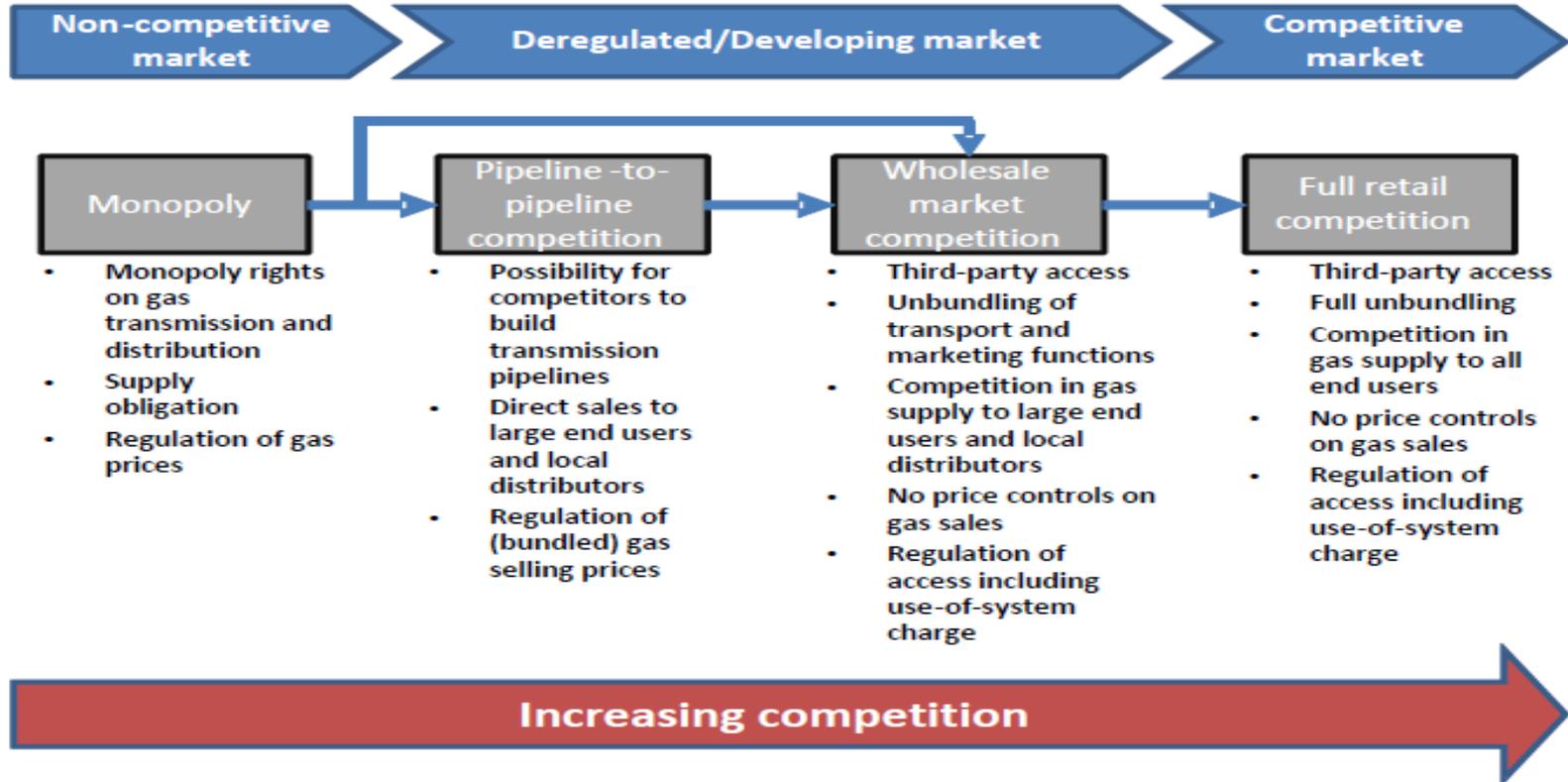
Incremental measures may be necessary **to break the control of incumbents:**

- *Capacity and commodity release programmes.*
- *Development of balancing and trading markets and liquidity.*
- *Gradual introduction of competition, e.g. industrial consumers before domestic consumers; incremental removal of price regulation while managing consumer protection.*

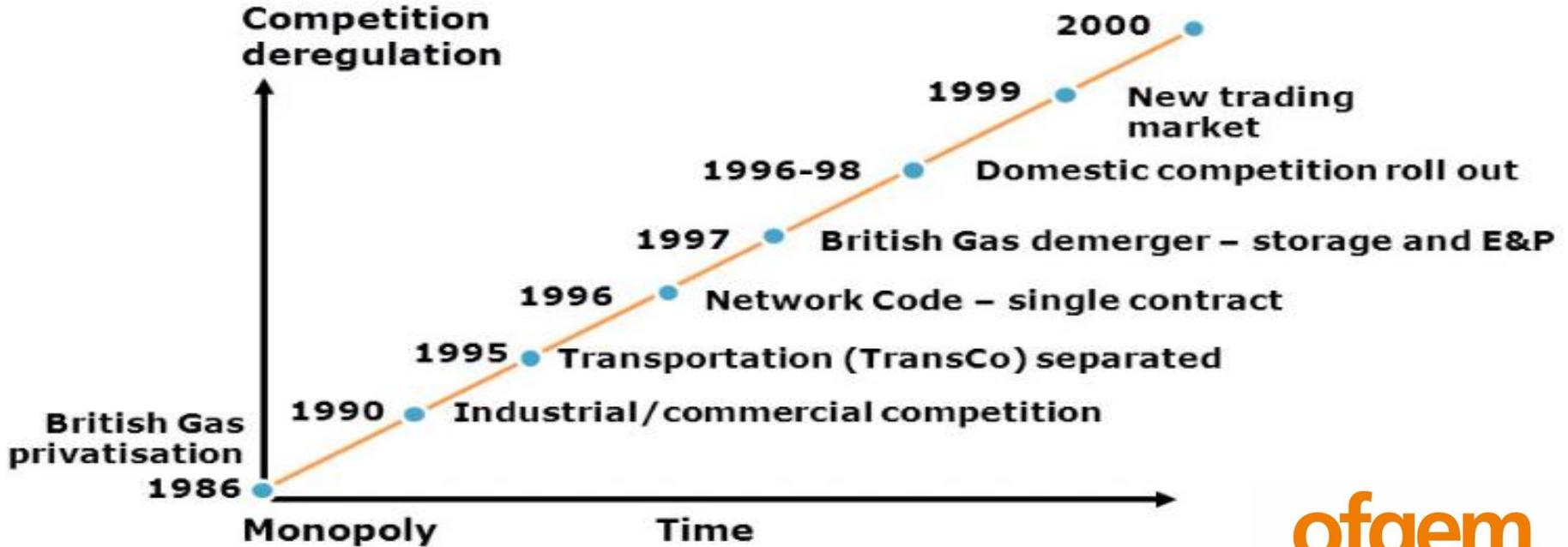
Roles and responsibilities – UK example



Phases of market opening



Evolution of the natural gas market in Great Britain (1986-2000)



▶ Development of an independent transmission system and introduction of competition was an **incremental process**.

▶ Change was **driven by policy intervention** and primary legislation.

Government policy is key. A clear legal framework and regulatory certainty are critical for the development of competition and market-driven investment.



Independent regulation is critical for regulation of monopolies and market rules.

- *Roles and responsibilities for the regulator/government and other agencies must be clearly set out*
- *Industry engagement is key with consultation and appeals processes.*



Transparency and non-discrimination are fundamental principles.

- *Network codes should set out a level playing field for all market participants.*

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USA

1985 Order 436

Allowing users to sign contracts directly with manufacturers, encouraging the provision of pipeline services to third parties

1978

Natural gas policy encouraging pipelines to provide access to their transport services

1992 Order 636

Completely removed the "bundling" of natural gas sales with pipeline transport

2000 Order 637

Further removal of "bundling" between natural gas sales and pipeline transport

1998

The first Gas Directive required non-discriminatory access to 20% of the market in transport services, introducing the concept of "unbundling" without being obligatory

2003

The second Gas Directive made it obligatory to "unbundle", and launched the proposal that households should be free to choose their natural gas supplier

2009

The third Gas Directive was responsible for pipeline transport services becoming independent, giving customers the freedom to choose or change supplier

