mZINE

INDUSTRY INSIGHTS FROM MJMENERGY | EU GAS MARKETS ISSUE | April 2005

mWELCOME
mSTORY
mTRAIN
mPRICES
mFEATURE
mPHASIS!
mPATHY
mOFFERS

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"OPEN" MARKETS IN EUROPE?

How do competitors see the European Gas Market?

It’s approaching five years since the EU gas directive came into force in August 2000, promising market liberalisation, choice and lower prices for Europe ’s gas customers. In many ways the liberalisation agenda has moved swiftly since then, with much greater legal market opening than was anticipated at the time, but in other ways the practical effects of liberalisation in terms of choice and lower prices, have been slow to develop in many European markets. The first of an occasional series on European gas markets, this article looks at the context of European liberalisation as a whole and reviews the progress so far in the key market of Germany .

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MWELCOME

Hello and welcome to the April issue of MZINE, our free monthly newsletter. After looking at the UK gas supply last month, we thought it would be appropriate to look at the European gas markets with a focus on Germany this month, see MSTORY for the full story. At MPRICES we take a look at the Oil Forward Curve, whilst at MPHASIS Derek, our illustrator, has excelled himself with this months cartoon. Don't forget to check out our thought of the month at MPATHY, or MTRAIN for the latest training courses,

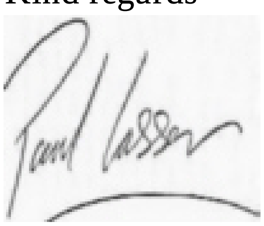
I hope you have a happy Easter and enjoy the extra few days off, if you have them.

If you enjoy reading this newsletter and think you know someone who might also enjoy it then feel free to forward it on.

Any one may sign up for this monthly newsletter, it is free and your details are protected.

Email: Go

Kind regards



Paul Cassar
Editor

top

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mTRAIN

Coming up over the next few months, the following training courses are being held in Oxford, England. They are all one-day events apart from the EU Gas Markets course which is an exciting two-day examination of EU gas market principles including an analysis of six European countries. More information about these courses can be found by clicking on the course title or visiting energytrainingnetwork.com and clicking on public courses. Alternatively you can contact me by email or phone +44 (0) 1865 395826, fax +44 (0) 1865 395959

May 10th	**EMISSIONS TRADING**	OXFORD
May 11th	**An INTRODUCTION to the UK GAS MARKET**	OXFORD
May 12th	**An INTRODUCTION to the NETWORK CODE**	OXFORD
June 7th	**An INTRODUCTION to the UK ELECTRICITY MARKET**	OXFORD
June 16th	**The Global LNG Market**	OXFORD
June 27/28th	**EU Gas Markets**	OXFORD
July 7th	**An INTRODUCTION to the UK GAS MARKET**	OXFORD
July 8th	**An INTRODUCTION to the NETWORK CODE**	OXFORD

OTHER DATES

LNG FINANCE FORUM The Waldorf Hilton, London, 9-10 May 2005

Tuesday 24th May to Friday 27th May Essentials of International Gas Trading

16th - 17th June 2005 Emerging Carbon Markets: Can they deliver?

Course Review

Essentials of International Gas Trading

Petroleum Economist's ***Essentials of International Gas Trading*** is an intensive four-day course, designed to give participants a comprehensive understanding of the way gas markets work and a practical appreciation of the principles, drivers and tools of trading in different gas markets.

Read the rest of this review

top

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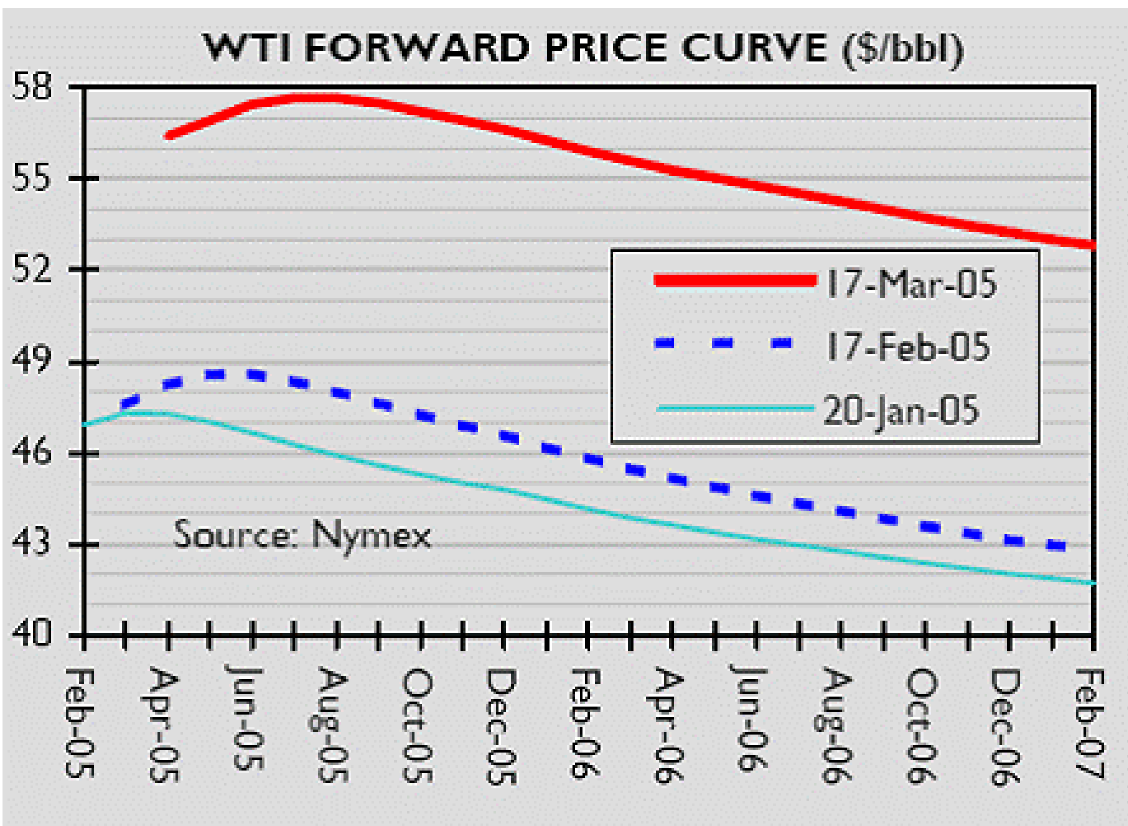
mPRICES

FORWARD OIL CURVE

Increasingly bullish demand forecasts, slower than expected growth in non-OPEC supply and fears of a downstream capacity squeeze later this year sent prices soaring again over the past month. WTI prices are $10/ bbl higher all the way along the forward curve and above $50/bbl as far ahead as 2008. The front end of the curve remains in a shallow contango, reflecting comfortable stocks in PADD II ahead of seasonal turnarounds, but the high absolute price level signals growing concern about the ability of the global supply system to meet strong demand growth in the future.



OPEC now recognises the problem and is attempting to allay market fears by boosting output in order to help the industry rebuild stocks ahead of next winter and reiterating its commitment to meet demand. However, this has only served to reinforce market concerns. The balance of Calendar 2005 WTI is $57/bbl – equivalent to nearly $55/bbl for Brent and over $50/bbl for the OPEC basket of crudes.

SWAPS PRICES

Period averages at close of business on 17/03/05

$/bbl	2Q05	3Q05	4Q05	1Q06	2006	2007	2008
WTI	57.40	57.35	56.49	55.49	54.31	51.87	50.29

Source: Intercapital Commodity Swaps Ltd.

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top

[top](#top)

mPATHY

thought of the month!

1 GOD, my shepherd! I don't need a thing.

2 You have bedded me down in lush meadows,
you find me quiet pools to drink from.

3 True to your word, you let me catch my
breath, and send me in the right direction.

Psalm 23 (The Message)

top

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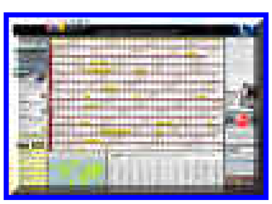
mOFFERS

this month's exciting offers!

Gas and Electricity Trading in Italy, written by Nick F White and Philip Pike and published January 2002. We have reduced the price of this report from £225 to £150* for our readers. To find out more about this report visit: www.energypublishing.com/Italy_about.htm



For 2005 we have produced a high quality A2 year planner detailing all of our training courses as well as space for you to mark those other important events. There is also other useful information such as a conversion chart relevant to the energy industry and netconnections, a list of web addresses at your fingertips. To receive one, please send me an email with your postal address and I will send you one with our compliments*.

*****(*while stocks last*)

top

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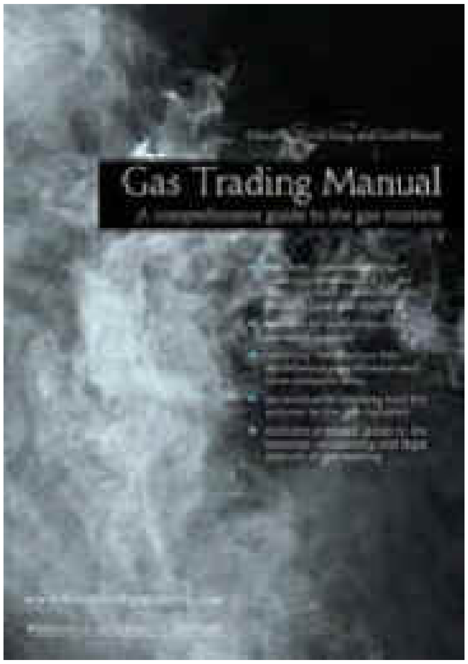
mFEATURE

The Gas Trading Manual



Much has changed in the international gas market since the first edition of **Gas Trading Manual** was published in 2001. As expected progress has continued towards greater market liberalisation. European gas and electricity markets are gradually being opened up to competition and EU energy ministers have finally agreed to speed up the process, setting a new target date of July 2007 by which time all consumers must be able to choose their gas supplier. At the same time mergers and acquisitions have changed the corporate landscape creating big new multinational utility companies with new priorities. Confidence in the role of trading has been hit by corporate failures such as the collapse of Enron which has forced many companies to re-evaluate the role of trading in their businesses. Nevertheless trading is here to stay and the opening up of the European gas and electricity markets continues to foster the development of new market structures wherever they are needed.

The new edition of GTM takes all these changes into account whilst presenting the single most complete source of information currently available on the international gas markets. GTM is the leading information source on this complex industry and this new edition is set to further enhance its reputation.

More information/order

top

 Anyone wishing to contact the editorial team with regards to any of the above articles should email: editor@mjmenergy.com, or phone +44 (0) 1865 395826

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Gas market liberalisation in Europe has been a long journey. Traditionally the gas downstream gas industry has been characterised by monopoly, often in the form of major national, sometimes state-owned, gas companies. One of the first steps was the passing of the Oil and Gas (Utilities) Act in the UK in 1982, which in theory allowed 30,000 large gas customers to contract directly with producers rather than buying gas from British Gas, with British Gas required to offer third party access to its transportation system.

However, the first actual competitive supply in the UK didn't emerge until 1990, with British Gas' stranglehold finally broken by some heavy-handed regulation by Ofgas. Eight years later, Great Britain became the first gas market in the world to be fully deregulated with competition extended to nearly 21 million customers.

Meanwhile the liberalisation process in Europe had hit a few roadblocks on the way. The European Commission first seriously proposed energy market liberalisation in its 1988 white paper, and in 1992 it launched a far-reaching Gas and Electricity Market Directive, which proposed, among other things, supply market opening, regulated third party access to transportation infrastructure, and legal unbundling of energy transportation and supply businesses. The Commission's draft directive was fiercely opposed by some member states and spent two years bouncing back and forth via committees in the European Parliament, before it was abandoned with the retirement of the Commission in 1994. The new Commission had learnt the strength of opposition to change and instead presented separate directives on electricity and gas. This gas directive still took a further four years to be agreed, and that in a watered-down state, allowing member states to opt for the minimum of internal accounts unbundling and negotiated third party access. The directive came into force in August 2000. The ink was hardly dry on the national laws implementing the directive (or in the case of France, not yet out of the inkwell) when the EU Heads of State agreed to further market liberalisation at the Lisbon European Council in 2000. This materialised in a directive revising the gas and electricity directives in 2003. Many of the provisions were oddly familiar from 1992, including mandatory regulated third party access and legal unbundling, but there was one crucial difference – the new (or accelerated) directive required full market opening for non-domestic customers right across the EU from July 2004 and for all customers from July 2007.

In 2005 where are we? In theory all non-domestic customers are eligible for competitive supply, but the level of competition in practice is very varied, from Britain , where competition is well-established, to Germany , Austria , Sweden or Denmark , where there is very little competition in evidence.

As can be seen from the graph, a reasonable proportion of large users have switched in a number of countries, but the level of small user competition is woeful across almost the whole EU, with only the UK and Italy able to boast of levels above 5%.

Sources: DG TREN and MJMENERGY estimate

The German gas market and pipe-to-pipe competition

Germany is the second largest gas market in Europe (and the fourth largest in the World) with consumption in 2003 of 96 bcm. The German gas market is unusual in Europe in that it has never had strong state involvement, but rather has developed a complex structure based on a number of major private producers, transporters and suppliers, and local distributors often related to local municipalities (Stadtwerke). There are over 700 gas transporters, although the market is dominated by a number of supraregional players, notably Ruhrgas, Wingas, RWE Gas, BEB, VNG and GVS. These players often have strong links with their major customers – regional transporters, local distributors and Stadtwerke – through complex chains of cross-ownership. Until 1998 the major players controlled supply through a range of demarcation agreements, which in effect split up the country into a string of de facto monopolies, with the players agreeing not to compete in each others' demarcated areas. This harmonious arrangement was disrupted by the entrance of Wingas in the early 1990s. BASF, owner of the then largest gas consumer in Europe, the chemicals plant at Ludwigshafen , had approached Ruhrgas for terms to transport Norwegian gas on its behalf. Unimpressed by the terms offered it by the German gas giant, BASF, through its oil and gas exploration business Wintershall, set up the joint venture Wingas with Gazprom, the Russian gas producer, which was keen to enter the lucrative German market in its own right. Denied the chance for third party access on existing pipelines, Wingas swiftly built its own pipeline network, in places shadowing the Ruhrgas national network, and started to compete in everyone's backyard for gas supply.

Third party access – VV style

Wingas brought a measure of competition to the German gas market, but at huge cost, spending over €5bn to build a pipeline network and capturing up to 15% of the German gas market over ten years. However, competition was limited to areas where there were Wingas pipelines and there was no chance of competition for smaller customers. In 1998 the German Federal Government passed the Energy Industry Act, which introduced 100% legal market opening and required negotiated third party access to infrastructure. Implementation of the negotiated third party access (tpa) regime was left to German industry in the form of the Verbandevereinbarung (Associations Agreement) – a framework for tpa put together by the associations of large gas companies, local gas companies, industrial customers and industrial cogenerators. The energy traders and new entrants were not represented. VV went through a number of incarnations, but remained a loose document, not providing sufficient definition on a number of key issues such as flexibility and load profiles, and the actual ease of third party access in Germany remained very low. Enron managed to achieve it after lengthy legal wrangling with Ruhrgas and with the help of the Bundeskartellamt (Federal Cartel Office), but few other players had the legal resources, or nerve, to follow where Enron had gone.

Now in 2005 a degree of competition has emerged, but tortuous third party access arrangements and the dominant positions of regional incumbents, has led to many competitive gas offers resulting in contract renegotiations with the existing supplier, rather than actual switching. Although this may give the appearance of competition, in terms of reduced prices and changing contract terms, it may not be in the interest of consumers (or economic efficiency) in the longer term, as, once potential competitors have spent their marketing budgets and gone off to find more lucrative opportunities, the incumbent may exploit its undiminished market power to maintain or increase price levels. On the topic of undiminished market power, the approval of the German Government to E.On’s merger with Ruhrgas, has also not been a positive step. Although some conditions were imposed, such as the requirement to release certain volumes of gas to the market, and the divestment of certain shareholdings in other gas players, E.On-Ruhrgas’ market power was in the main increased by the takeover, creating a hugely powerful gas and power player not only in Germany, but in a number of other European markets.

Regulation, regulation, that’s what it takes…

What is being done to bring change in this key European market? There have been many developments over the last year or two that give the promise of more effective liberalisation, although the fruit is yet to be seen.