

Panel 1: Promoting competition in energy markets: regulation and merger control

REGULATION, COMPETITION & INVESTMENT: Experience in the British gas market

Paul Hallas – Director of Gas Supplies,
Centrica Energy

12 February 2009

Overview of the British gas market

SUPPLIES:

- ◆ Declining UKCS
- ◆ Growth of imports
- ◆ Norway, Netherlands
- ◆ LNG re-gasification

DEMAND:

- ◆ Market c.100 bcm/a
- ◆ Key residential fuel
- ◆ Large & growing role in power generation

STRUCTURE:

- ◆ 6 main competitors
- ◆ High retail switching
- ◆ Large, liquid traded market (NBP)
- ◆ Network ownership largely unbundled

Climate for
investment &
competition

ENERGY POLICY:

- ◆ Market-oriented
- ◆ No “national champion”
- ◆ Supply (& price?) security
- ◆ Sustainability
- ◆ Fuel poverty concerns

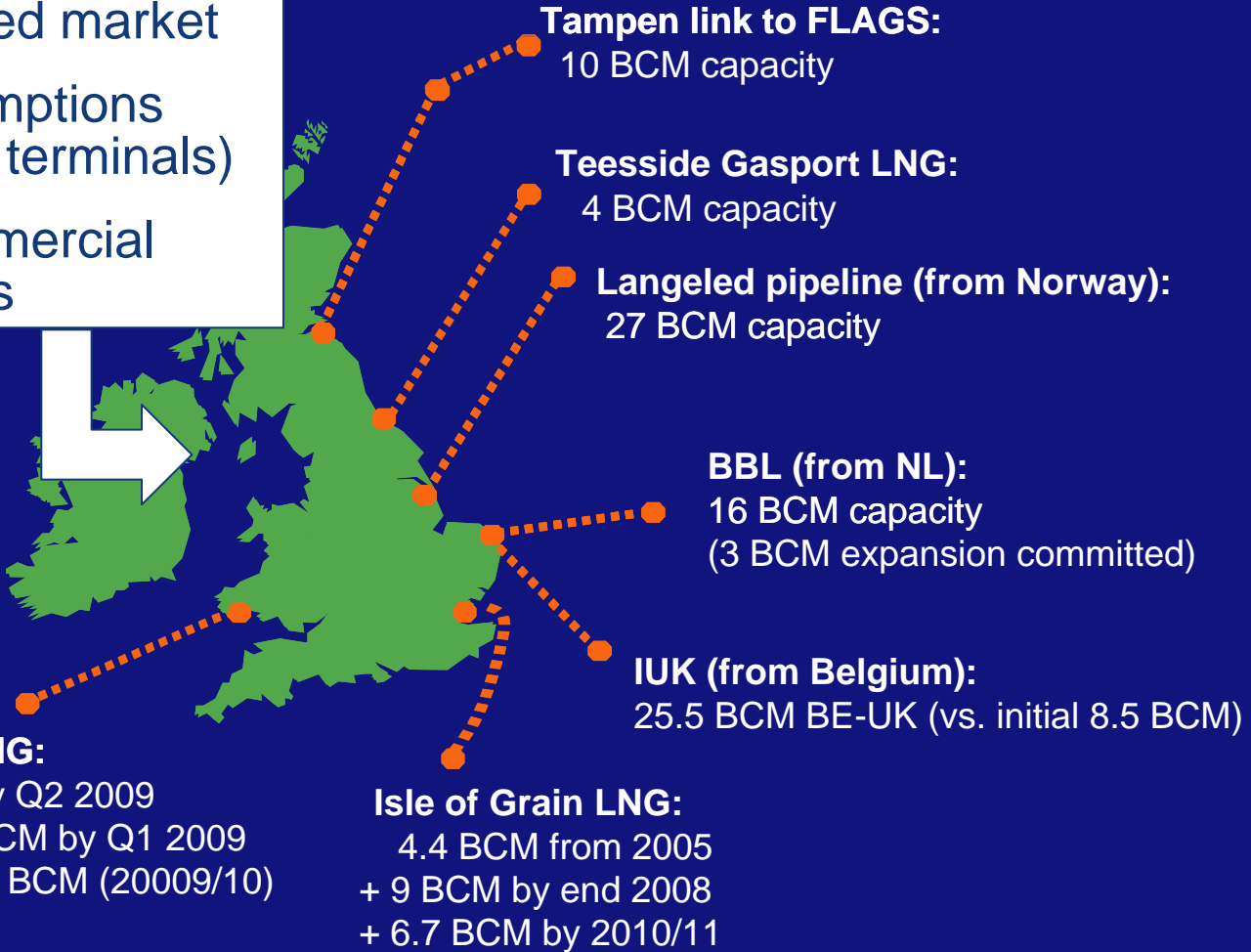
REGULATION & COMPETITION POLICY:

- ◆ Mature network regulation, with incentives
- ◆ Retail price controls lifted in 2000
- ◆ Concurrent Ofgem competition powers
- ◆ Merger control via OFT

centrica
energy

Import infrastructure: > 120 bcm/a of new capacity

- ◆ Liquid traded market
- ◆ RTPA exemptions (LNG re-gas terminals)
- ◆ Major commercial commitments



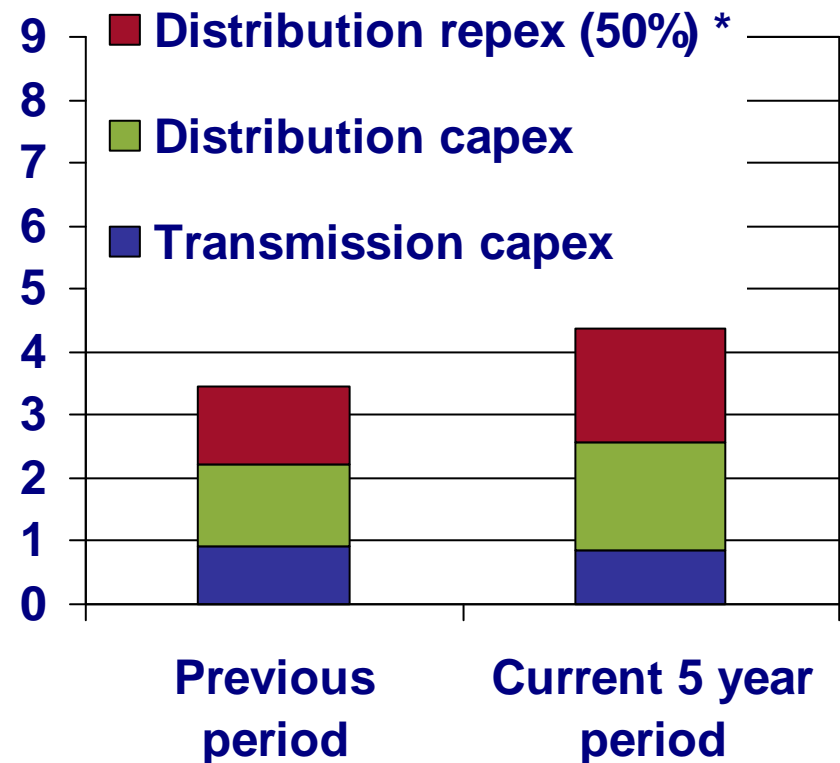
Abundant, diversified import capacity will do much to support a competitive wholesale gas market

Onshore gas networks

- ◆ National Grid NTS (TO & SO)
- ◆ Mixed ownership of distribution
- ◆ Mature & relatively stable regulatory framework:
 - 5 yearly price control reviews
 - “RPI+/-X” & SO incentives
 - Regulatory oversight of charging methodology
- ◆ Uniform Network Code (UNC):
 - non-discriminatory access
 - right of appeal to Competition Commission
 - NTS Entry capacity auctions since ‘02 (“user commitment”)
 - NTS Exit reforms approved
- ◆ Major Ofgem reviews in progress:
 - “RPI-X at 20”
 - Code governance

Gas network capex

(£ bn, 2005/6 prices)



Source: Ofgem

* 50% of repex is capitalised under Gas Distribution Price Control

centrica
energy

Gas storage - access & investment

◆ Clear market need, given decline of flexible UK supplies - will also help to support effective competition

◆ Existing storage:

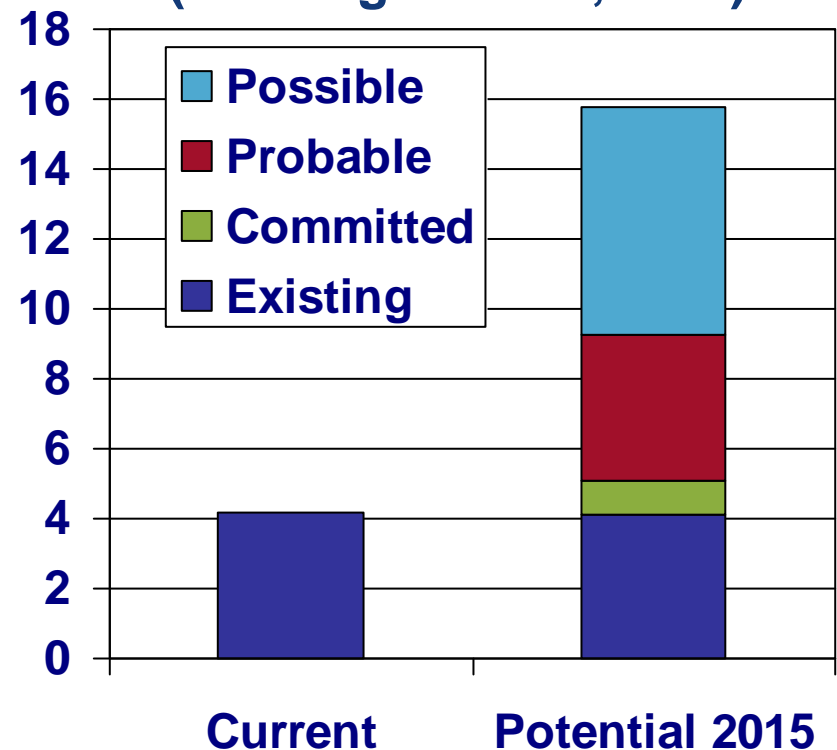
- NTPA re long-standing facilities
- Rough Undertakings (CE reservation limited to 15%)
- some LNG storage reserved for grid Operating Margins

◆ New storage:

- typically TPA exempt
- onshore planning delays eased
- construction projects mainly onshore salt caverns
- CSHL & others looking to develop larger offshore storage

◆ Impact of credit crunch & cushion gas costs on storage projects

**UK Storage Capacity
(working volume, bcm)**

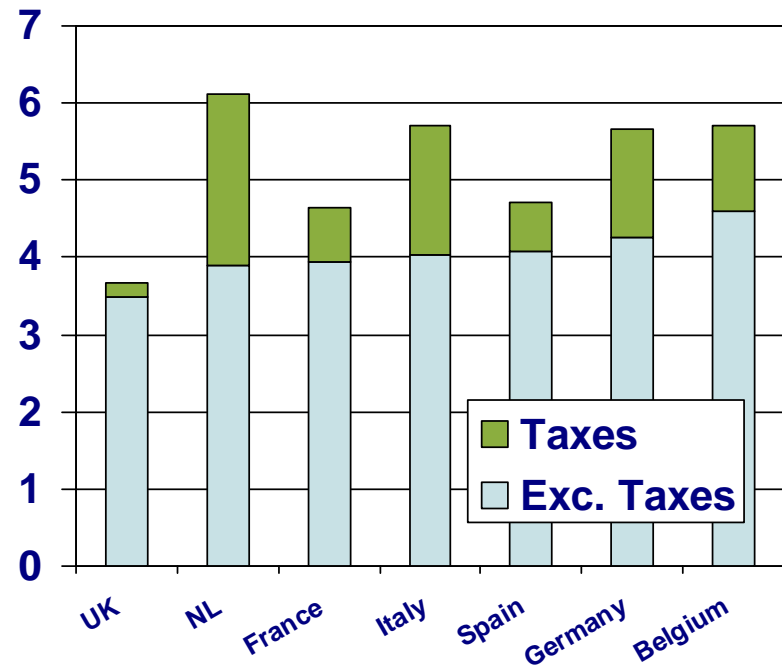


Retail supply competition

- ◆ Competition mainly in “dual-fuel”
- ◆ Retail switching rates remain high
- ◆ Oil-driven wholesale price rises led to large tariff increase in '08
- ◆ Retail gas prices nevertheless remain low vs. other EU states
- ◆ Clear political concern re high bills & impact on vulnerable – but tariffs now beginning to fall
- ◆ Recent Ofgem probe findings focused (inter alia) on:
 - cost-reflective tariff differentials
 - in-area vs. out-of-area (elect.)
 - “elect only” margins higher than gas
 - some concerns re wholesale power market liquidity (esp. “down the curve”)

Residential gas prices

H2 2008 (p/kWh)



Source: DECC

Wider European gas market developments

Policy & regulation

Positive developments:

- ◆ Progress towards 3rd package
- ◆ Gas Regional Initiatives:
 - greater information transparency
 - more focus on cross-border issues
- ◆ Enhanced transmission regimes:
 - wider use of incentive regulation
 - development of Open Seasons
 - Zones consolidated (France, Germany)
 - balancing reforms (Germany)
 - socialised quality conversion (NL)

Key concerns:

- ◆ “Less than 3 shippers” (non-transparency)
- ◆ Open Seasons often poorly co-ordinated
- ◆ Very limited open access to storage & non-compliance with GGPSSO
- ◆ Hourly balancing without info/tools to manage imbalances

Industry & competition

Positive developments:

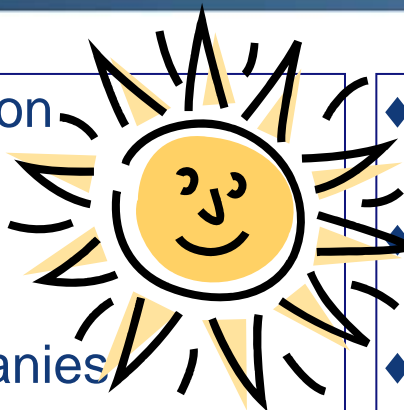
- ◆ Competition remedies:
 - “contractual foreclosure” (e.g. Belgium, German City Gates)
 - proposed RWE gas grid disposal
- ◆ Merger remedies:
 - E.ON gas release
 - sale of Distrigas
- ◆ Cross-border grid merger (GTS/GUD)

Key concerns:

- ◆ Frequently high market concentration
- ◆ Impact of “legacy contracts” (contrast to UK)
- ◆ Examples of contractual congestion (anti-hoarding measures ineffective)
- ◆ Industry consolidation & asset swaps among already dominant incumbents
- ◆ Only limited traded market liquidity
- ◆ Politically vulnerable supply routes (Russia/Ukraine)

Remaining concerns re the “un-level playing field”

Alternative European gas futures...



- ◆ Timely implementation of 3rd package
- ◆ New laws properly enforced
- ◆ Transmission companies aiming to be just that
- ◆ ACER & ENTSOG work effectively
- ◆ EU Regulations/Codes replace current non-binding guidelines
- ◆ Investment responds and access barriers are seriously tackled
- ◆ Market functioning transformed
- ◆ Gas is able to play the role we want/expect, across the EU



- ◆ Implementation delayed & incomplete
- ◆ 3rd package enforcement no better than the 2nd
- ◆ Conflicts of interest foreclose markets
- ◆ New institutions fragmented
- ◆ Non-binding guidelines continue to be widely ignored
- ◆ Uncertainty & barriers to entry hamper investment/competition
- ◆ Gas market remains badly flawed
- ◆ Adverse effects on European economy and environment