



A road map towards a competitive gas market

Preamble

Romania is required to implement the EU Directives and apply the EU Network Codes and thereby liberalize the gas market this decade. A significant legislative and regulatory effort and effective implementation are required to allow the country to move from a regulated market to a competitive gas market.

This paper highlights important elements of the liberalization process along the gas value chain. It discusses the reform steps on a road towards a fully competitive, interconnected and transparent gas market in Romania which facilitates gas supplies to Romania from diverse sources, provides security of supply to consumers at competitive prices which develop freely based on demand and supply fundamentals, and is based on a stable legislative framework attracting investments also from international investors. FIC asks that legislation and regulation needed in the context of reform is developed in dialogue with all stakeholders with sufficient time given during consultations to review and comment on proposed legislation to avoid unintended consequences.

Domestic gas resource development

The security and diversity of gas supplies to the Romanian consumers is increased by the development of Romania's domestic gas resources, the expansion of the national gas transmission system and its better interconnection with neighbouring systems. This will foster the competitiveness of the Romanian gas market and increase cross-border trade with neighbouring countries. Investments into gas resource developments create significant economic benefits to the Romanian Government and the people of Romania and will generally foster Romania's competitiveness in the region:

- FIC stresses that the stability and predictability of Romania's legislative environment in general, and its fiscal regime in particular, over the entire lifetime of gas resource projects are pre-requisites for successfully unlocking Romania's energy resources to the fullest possible extent. The stability and predictability of the fiscal terms is of particular importance for resource developments because of the large associated upfront investments and the very long-life cycles of such projects that may require investments many years before the production can start up.
- FIC suggests that royalty payments are calculated as a percentage of the net revenue (market value) that is actually achieved by a producer from the sale of its gas.



Gas transmission infrastructure and cross-border interconnection

Better physical and commercial cross-border connections of the Romanian national gas transmission system with the systems of its European neighbours support the Romanian gas market becoming a more integrated part of the single EU gas market and thus increase “security of supply” to gas consumers in Romania and “security of demand” for producers (because of an increased access to a large, competitive market). Better connections will thereby support the evolution of the Romanian gas market towards a liquid gas market and investments into the development of new gas resources.

- FIC supports cross border gas pipeline infrastructure projects such as the BRUA project and other CESEC Projects of Common Interest and encourages the integration of Romania’s gas market with the neighbouring markets and the wider CEE region in line with principles of an Energy Union. To this extent, investments into gas infrastructure and operating pressure for physical interconnections need to be progressed, including reverse flow capabilities.

The wholesale gas market framework

Producers and wholesalers must be able to market their gas portfolios in open competition at market-based prices. They must be free to negotiate commercial arrangements with counterparties of their choice and have a high degree of comfort that the legislative market framework in Romania will allow this also in the future. Freely developed commercial arrangements provide efficient solutions meeting the needs of all contract parties. Actual or threatened regulatory interventions can distort investment incentives and create unintended consequences. Market based price formation supports trade, investment and efficient resource allocation and utilization, thereby allowing local production to compete with international supplies and facilitating the sustainable development of a cost efficient and competitive gas industry in Romania. Unrestricted import, export and trade allows producers and wholesalers to leverage the benefits of an open market, thereby supporting supply and demand efficiency and increasing security of supply in Romania.

The development of a competitive wholesale gas market is supported through a legislative framework (consistent with the EU gas market framework / Network codes) which allows demand and supply to meet at a “virtual trading point” (VTP) or “Hub” in the national transmission system of Romania, whereby trading activities are facilitated by organized market places. Thereby a “liquid” market is typically a market with a high number of both sellers and buyers, where traded products allow market participants to balance their gas portfolios on a daily basis and to manage/hedge portfolio risks on a longer term basis, where traded volumes are high compared to the overall market size, the number of transactions in a given time is high, reliable price indices can develop (reflecting market fundamentals), where bid-ask spreads are low and the market has a significant “churn-rate” (the number of times gas is sold before it is physically supplied).



- FIC supports the development of the Romanian gas market towards an increasingly competitive and liquid market where gas is offered also on a daily basis.
- FIC supports the full implementation of the EU's Third Energy Package in Romania and the associated EU Network Codes including on capacity allocation, congestion management, and the (daily) balancing regime. Detailed short-term implementation needs in Romania require the regulatory framework to:
 - allow (not oblige) demand/supply to aggregate at one market place, i.e. enable network users to sell/buy (title transfer) within the NTS system at a VTP / Hub operated by Transgaz,
 - trigger daily demand and supply at the VTP by requiring and enabling network users to balance their gas portfolios on a daily basis based on transparent, non-discriminatory terms, regular information about net balance positions and market based balancing transactions (such daily trades will also create a nucleus of liquidity),
 - facilitate continuous trading of standardized products (i.e. a flat delivery of gas for a certain period such as balance of the day, day ahead, month ahead, quarter ahead or year ahead) at the VTP through alignment of transportation and sales product terms and allowing multiple brokers including centralized market operators to compete for broker services,
 - enable parties to trade gas at the VTP without the need for a supplier license or becoming a network user.
- FIC considers that bilaterally negotiated long-term (i.e. > one year) contracts are pivotal to underpin the significant investments into domestic gas resource development and related transmission infrastructure and to enable market participants to manage/hedge gas portfolio risks in so far as they contribute to the development of a competitive Romanian gas market.
- FIC considers that standardized contracts on organized trading platforms with delivery at a VTP/Hub are important market instruments to enable the development of market liquidity including price formation based on demand/supply fundamentals. The legislative framework must allow service providers such as brokers and exchanges to facilitate the trading of standardized contracts. Thereby, in Romania, the so called "Centralised Markets" have a key role to facilitate the development of market liquidity, generate price signals and decrease transaction cost.

Storages

In addition to gas production, imports and demand side reactions, gas storages are an essential element of the gas value chain to balance demand and supply. They allow market parties to e.g. inject gas in the summer when demand can be low and withdraw it in the winter when demand can be high. Market participants must be sufficiently incentivized to store gas to ensure secure supplies to end-consumers also at times of extreme demand.

- FIC considers that the level of storage obligations should be set such that it ensures security of supply. In addition, investments in increased withdrawal capacity, faster injection/withdrawal switch-times, and a more responsive regulation to market conditions are needed. It can be expected that once the



market develops seasonal price patterns (i.e. a summer-winter price spread) market incentives to store gas may develop.

- The current storage obligation applies to suppliers to end-consumer and the TSO, it must not be an entry barrier for market parties to become active at wholesale level or trade gas at the VTP. This would seriously impact the development towards a more liquid and transparent market.

The distribution systems

Gas distribution systems are a critical part of the gas infrastructure. They ensure secure supplies to final consumers.

- FIC suggests that distribution tariffs should be set at levels which enable system operators to economically conduct needed modernization works and maintain system integrity. The legislative framework should allow distribution systems to be expanded where demand exists and it is economically efficient to do so.
- In the context of new gas resources available, the authorities may wish to incentivize the use of natural gas and a gradual extension of distribution networks to new customers or communities. System expansions should be based on a minimum demand commitment from new consumers or communities underpinning expansion investments.

The retail market

Market parties active in the retail segment of the gas value chain typically buy gas at the wholesale market from producers at delivery points in the NTS. It can be expected that once a VTP is established, such parties will increasingly buy gas at the VTP.

The deregulation of wholesale gas prices and the continued regulation of prices for supplies to household end-consumers creates a potential margin squeeze for market parties active in the regulated retail market. Economically efficient acting retail companies must be able to recover the real cost for gas purchases, transmission, storage, distribution and marketing.

- FIC suggests that where end consumer prices are regulated, they are set at levels which reflect real wholesale prices and are updated monthly or quarterly to reflect changing wholesale prices.
- To facilitate the transition from regulated to market-based gas prices, FIC suggests that an effective support mechanism for vulnerable consumers in need of direct financial support should be enforced.



Emergency plans

Romania needs to develop and implement an effective emergency plan, which can be applied when all market-based measures are exhausted. Such a plan needs to stipulate amongst others communication protocols, clear emergency measures and responsibilities, definitions for protected and interruptible customers and commercial conditions under which emergency measures are implemented.

- In this context FIC suggests the effective implementation of the EU Security of Supply Regulation EU 2017/1938.