

# Slow progress in liberalization of France's gas market

An open market for gas in France remains some distance away because of obstacles for new entrants and the power wielded by the incumbent suppliers. But progress remains possible. By Thierry Chaumeil

In the midst of the inquiries raised by the European Commission with respect to obstacles preventing the development of competition in the European gas market, and the constraints pointed out by the Commission in its annual report published earlier this year, the status of the liberalization of the gas sector in France is no exception to the gloomy landscape.

As in many other European countries, the principal market player in French gas sector enjoys a strong position and its new competitors have been unable to more than dent its near-monopolistic market share.

But, although still in its infancy, competition is showing some progress, especially in the northern regions of France, where the high density of gas-related infrastructure and equipment helps.

France was not, this time, the last country to implement a Directive aimed at energy liberalization. Contrary to the 1996 and 1998 gas and electricity directives (finally implemented in January 2003), the June 26 2003 directive became national law on August 9 2004, meaning France was not placed on the list of member states summoned by the Commission for failure to implement this newest piece of EU gas legislation.

But a timely implementation does not mean France embraces competition with enthusiasm. While other member states immediately opened the entire gas sector to competition, France has decided to use a two-step process, starting on July 2004 with the opening to competition in the professional and industrial markets and ending in July 2007 with the opening of the household market.

In recent months, observers of the French gas market have seen numerous initiatives, many of which should have a positive impact of the development of competition. These include the transfor-

mation of Gaz de France (GdF) into a limited liability company, followed by its part-privatization, gas releases giving opportunities to new entrants to purchase bulk gas, the unbundling of the transmission sector with the creation of two separate entities from Total and GdF, new regulations on the definition of the balancing zones, and access to transmission infrastructure.

These initiatives shed new light on the awakening to competition of what is considered to be the EU's fourth biggest gas market in terms of volume.

## Principal obstacles to competition

The emergence of competition in the French gas industry suffers from external and national constraints that cannot be efficiently remedied in the short term.

**1. The price of gas**  
France has almost no indigenous gas production (it is just 3% of consumption), so France imports 97% of consumption from three principal external sources: Russia, Norway and

Algeria. In terms of volume, GdF has entered into long-term agreements covering more than 90% of French market consumption. This makes the French gas market highly vulnerable to price fluctuations, and this structural weakness adversely impacts the development of competition.

### *Price fluctuations at the European level*

In recent months, as a consequence of the indexation mechanisms in the long-term supply agreements entered into with non-

EU suppliers, increases in gas prices in Europe have closely followed the increase in oil prices. At the same time, the prices of gas on the spot markets followed a similar trend and reached levels close to, and sometimes higher, than the prices paid by historical gas operators under long term supply agreements. The future does not look encouraging, as forward prices are higher than prices under long-term agreements.

In France and other EU member states, higher prices first hit new entrants to the gas market, who have no historical access to traditional foreign suppliers and who have no other solution than to purchase bulk gas at uncompetitive wholesale prices on the market.

### *Regulated prices*

In France, the coexistence of regulated prices (not always reflecting actual costs) together with market prices has a negative effect on the selection of suppliers by industrial and business consumers.

Up to 640,000 industrial and business consumer sites are considered eligible in France to select their gas provider. As of May 1 2005, about 35,000 had selected a supplier and most elected to adopt the market prices offered by the incumbent operator. Only 308 sites selected an alternative gas provider providing gas at market price. In other words, more than

90% of the eligible French sites have elected not to change suppliers and therefore continue to purchase gas at regulated prices which, in many cases, the historical gas operators provide to them at a price below what new entrants, hit by the increase in whole-

sale prices, can offer.

One of the objectives of the French gas regulator, the Commission de Régulation de l'Énergie (CRE), is the suppression of regulated prices for eligible consumers.

## 2. The uneven density of gas infrastructure in France

In terms of gas infrastructure, France is divided into two geographical zones, one northern, one southern, where the respective levels of competition cannot yet be compared.

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*The northern regions*

The northern regions, including the northeastern regions, have a higher density of population than the rest of the country. This explains, at least partly, why competition has found fertile grounds there, as acknowledged by the European Commission.

The northern regions of the country have also, from a gas infrastructure point of view, most of the infrastructure required for competition to develop: a solid transmission network, one methane terminal in the west on the Atlantic coast (Montoir-de-Bretagne), three pipeline entry points near the border with Belgium (Dunkerque, Obergailbach and Taisnières), one pipeline entry point on the border with Germany (Oltingue), as well as many storage facilities.

The situation in the southern regions of France is less encouraging.

*The southern regions*

The reach of the transmission network is less developed in the south than in the north and the existing structure of the national transmission network does not allow enough southbound gas flow.

Until very recently, the only gas entry point on the French territory in the south was the methane terminal of Fos (Fos Tonkin), on the Mediterranean sea. But the Fos terminal is not equipped for the unloading of liquefied natural gas (LNG) from the largest methane ships.

But the infrastructure situation is evolving, although its effect on competition will not be seen for a few years. Earlier this year, a land interconnection with Spain was completed (Port-de-Larrau). Another pipeline with Spain will soon be in service (the Euskadour project led by Total), the purpose of this will be to connect the storage facilities located in the Bayonne region in France with the methane terminal near Bilbao in Spain. In addition, a new methane terminal will be opened in 2007 in Fos (Fos II Cavaou) with a capacity of 8.3 Gm<sup>3</sup>. The shareholders of this new methane terminal are GdF (70%) and Total (30%).

To foster competition in the short term, a gas release program took place in the south of France at the end of 2004, with GdF and Total releasing together a total of 16.1 TWh (terawatt hours) a year for three years. All batches were sold, either by auctions or, subsequently, by over-the-counter transactions with respect to the batches that could not be sold during the auctions. BP, Distrigaz, Gas

Natural, Iberdrola and EDF were among the purchasers.

**Market players**

In France, the top three gas suppliers have a market share of 91% and the market share of foreign-owned suppliers has been so far limited to 3%.

In addition to the two main French players (GdF and Total), one of the unique aspects of the French market is that it has 22 independent local distribution companies or entities, placed under the control of their respective municipalities, most of them in small or medium-sized cities, but also in bigger local markets such as Bordeaux, Strasbourg and Grenoble.

*The incumbents*

In recent months, historical operators have been told to adjust their corporate structure and market position to comply with the new gas regulatory framework. GdF was transformed into a limited liability company with the French state as sole shareholder. In early July 2005, more than 20% of its shares were placed on the market with a gain for the company estimated at about €2 billion. After the offering, the state remains the majority shareholder of the company, with 78% of the shares and a windfall of €2.5 billion.

On January 1 2005, in accordance with unbundling requirements in the 2003 gas directive, Total and GdF each set up legally independent transmission entities named: Total Infrastructures Gaz France (TIGF) and Gaz de France Réseau Transport (GdF RT), respectively. In order to foster the development of competition in the south, Total and GdF put an end to the cross participations they each held in two joint ventures covering each almost half of the southern territory of France. Within the scope of this operation, Total is committed to, among other things, improving access by third parties to certain transmission and storage facilities.

In spite of these efforts, criticisms continue to be directed at the two dominant French players. First, deficiencies remain with respect to the separate accounting obligations that must be complied with by historical operators, as well as by local distribution companies. With respect to the two new nominally independent transmission companies, the fact that they use the name of their parent entity is not an encouraging sign in terms of their independence. The CRE, the French regulator of the energy sector, has also

indicated that in terms of investment and management, the independence of the transmission entities is not yet enough.

*The new entrants*

According to the latest figures released by the Ministry of Finance, 28 providers (including GdF, Total and their affiliated companies) are authorized to supply gas, in addition to the 22 local distribution companies authorized to supply gas within the limits of their local market.

New entrants belong to several categories and do not share the same ambitions in terms of investment, market segment and expected gain of market shares.

In the first category are the French subsidiaries or branches of other European players in the gas sector, based in Germany (E.ON Ruhrgas, Wingas), Spain (Iberdrola, Gas Natural), Italy (ENI SpA) and Norway (Statoil). Another group is made up of dedicated entities set up by French companies or companies with a traditional presence in France (BP France, EDF, Air Liquide, Rhodia Energy). A final category is made up of the start-up players, such as Altergaz and Poweo.

Before any new entrant can do business in France, the Ministry of Finance must grant an authorization pursuant to a decree dated March 2004. The authorization process might be seen as unnecessarily long and cumbersome, and applies to all gas suppliers, distributors, resellers or traders. It is designed to prevent the arrival of fly-by-night gas operators by giving the Ministry a chance to assess the technical, economic and financial capacity of the operator and the compatibility of its project with the *service public* obligations. A proposed supplier must provide, among other things, the following information: categories of targeted clients; provisions of the supply agreements with its future clients; transmission capacities, a five-year business plan; a five-year and 10-year gas supply forecast; and measures to ensure continuity of the gas supply. Once the requested information has been provided in full, the Ministry can take up to five months to deliver (or deny) the authorization.

**Regulation of the gas sector**

The regulation of the gas sector is divided between the Ministry of Finance and the CRE. Decisions such as authorization of suppliers and regulated prices are under

the Ministry's jurisdiction, although the CRE often must be consulted beforehand. The CRE is in charge of issues including the management of networks and conflict resolution with respect to access to transmission, distribution networks and to LNG facilities. After due process, the CRE can also sanction operators for non-compliance with access rules.

*Recent regulatory measures in the gas sector*  
Recently, regulatory effort has been dedicated to the transmission sector, with the publication of several decrees and orders in May 2005.

A first order contains the new definition of balancing zones, the number of which has been reduced from eight to five, and should be reduced in the future to three. In France, an entry-exit price system applies to the so-called main transmission network, that is, from the gas entry point on the French territory to the principal storage areas. Prices on the regional transmission network are calculated based on the distance.

A decree deals with framework price rules applicable to the use of transmission networks charged by Gdf RT and TIGF. An opinion issued by the CRE gives additional specifications with respect to the same for each transmission operator. With respect to the distribution of gas, an order dated June 16 2005 defines the rules used for the calculation of the price applicable to the sale of gas from the public distribution networks.

*Next regulatory measures*

Two orders of the Ministry in charge of energy are expected soon in connection with the following areas: (i) rules regarding the price applicable to the use of LNG installations (methane terminals); and (ii)

the definition of the procedure applicable to the exception to the principle of access by third parties to recently built infrastructures. The order will set forth the

terms and conditions of the exception regime authorized by Article 22 of the 2003 Gas Directive whereby investors can refuse access to new infrastructure if, among other things, the purpose of their investment is to enhance com-

petition in gas supply and enhance security of supply. ■

**In other words, more than 90% of the eligible French sites have elected not to change suppliers and therefore continue to purchase gas at regulated prices**

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