22/06/2012

Dear Madam, Sir

Gazprom Marketing & Trading Limited Response to CRE Consultation the evolution of market places in France.

GM&T is the UK registered wholly-owned subsidiary of Gazprom Group ("Gazprom"), responsible for the optimisation of Gazprom's energy commodity assets through GM&T's marketing and trading network. GM&T Ltd is active as a trader and marketer of gas at various points in Europe, and especially in France. It is also engaged in the Retail business through its subsidiary Gazprom Marketing and & Trading Retail Ltd.

Therefore, it has a keen interest in ensuring a workable French gas market on both points of views.

We would like to thank the CRE for offering a chance to discuss the future structure of the French market. We would also like to thank GRTgaz and KEMA for the study performed and all the elements provided to appreciate the implications of the evolutions of the market places in France.

As an introduction, GM&T Ltd would like to provide a short analysis on the current situation of the French market. Historically, the French network has been designed to work as a whole, where the transmission system, the underground storage and the LNG terminal were working together to ensure security of supply for all customers.

The liberalisation of the European gas markets, introduced by the successive EU Directives, as well as their globalisation, and in particular the development of LNG trading, have been dramatically changing the historical balance of the French market.

The increasing LNG demand after the Fukushima event has been drying up European LNG Terminals. In some countries, the impact has been reduced, and supplies from pipe gas have been able to maintain the balance of the networks without dramatically altering the level of the market price. This is the case for the North of France, where sufficient capacities at entry points have been able to mitigate lower deliveries at Montoir LNG Terminal.

However, this is not the case of GRTgaz South balancing zone. The conjunction of historically low LNG deliveries at Fos LNG Terminals and the historical congestion hampering gas to flow from North to South have been dramatically affecting the market in the South of France. Wholesale prices are decorrelated from the North, with a premium well above the price of the capacity, and the liquidity at PEG South is a growing issue.

GM&T Ltd thinks that, in the current situation:

- The development of a sustainable portfolio in the south of France is hampered by the congestion between GRTgaz North and South.
- Under the current supply conditions, continuity of supply in the south zone can be at risk in case of high peak demand or failing infrastructure.
- The risk to see market manipulation in the south is high in the current situation

<u>Question 1</u>:

Do you believe that the PEGs should be further consolidated?

Yes.

The first sentence of the Memorandum proposed by the CRE perfectly reflects the importance of the reduction of balancing zones in the development of the French gas markets. At each step, from the former model with 7 balancing zones to the current 3 zones, liquidity has been improving and PEG Nord developed as a key market in North-Western Europe.

However, the physical congestion at the Link between GRTgaz North and South zones has been hampering the development of PEG South. The situation has been dramatically improving after the start of operations at Fos Cavaou LNG Terminal, but the recent drop in LNG deliveries experienced lately have been showing that the supply of the South zone remains highly uncertain.

Both on a retail and a wholesale point of view, the priority to move towards a liberalized gas market in France is a consolidation between GRTgaz North and South.

Considering that there is no congestion between GRTgaz South and TIGF, the creation of a single PEG France should be considered as a target. In the south, a minimum requirement would be a harmonisation of rules between GRTgaz and TIGF.

Note that the creation of a single zone in the South will not solve the congestion between the North and the South of France, whilst helping the access to clients in TIGF zone. A positive side-effect of this merger of the zone would be the creation of competition between Storengy and TIGF for underground storage capacity in the south of France.

Do you think that keeping the current contractual structure is a possible option?

Yes, if the costs of such a consolidation outpasses its benefits.

At this point, it appears that on the costs side, elements provided are still unclear and need further evaluations to really appreciate accurately the different scenarios. On the benefit side, whilst this consolidation should increase competition in France and help reducing the gap between the prices paid by clients in the north and those paid by clients in the south, a quantitative assessment is still missing.

The consolidation of GRTgaz South and TIGF could be performed at a limited cost. Hence, the benefits of such a merger in terms of competition in TIGF zone will be straight forward. The governance issues and TSOs strategy shall not be discussed here.

<u>Question 2</u>:

Are you in favour of creating joint procedures and information systems for GRTgaz and TIGF linked to these evolutions?

Yes.

GM&T Ltd supports the harmonisation of both the procedures and the IT systems for GRTgaz and TIGF, no matter the decision regarding the evolutions of the PEGs. This is a good example of a cost effective approach.

Do you think that the two French TSOs should take part European joint capacity selling platform announced in April 2012?

Yes.

The creation of a common booking platform would bring multiple advantages compared to independent platforms built up by each TSO. It would be highly desirable to see TIGF following GRTgaz's path and join the initiative launched to create a common booking platform for capacity. Especially considering that a consolidation of the PEGs (in the south only or in a France-wide zone) will imply at some point shared governance between TIGF and GRTgaz for the management of the network in the south of France.

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However, this question should be addressed in priority between TIGF and GRTgaz, along with the CRE and the Ministry.

Question 3:

What do you think of the conclusions of the KEMA study?

First, GM&T Ltd would like to thank KEMA for their valuable input in the decision process. Engaging in such a study is no simple task and the report provided is highly appreciated. The demonstration by KEMA that a physical congestion, remanent in terms of volume and frequency, at the North-South Link is the confirmation of what's been observed by market participants in France for several years.

In GM&T's opinion, scenario 1 is the most likely to happen considering the current and foreseable situation on the LNG market. In this scenario, the level of congestion is permanently high in the summer, and volatile in the winter, but with peaks up to 450 GWh/d. Considering these results, we can state that the congestion is structural and represent an important amount of gas, up to 500 GWh/d in the summer in case of low ToP constraints.

Considering the above, our opinion over KEMA's conclusions would be that:

1. Contractual tools are not the appropriate solution to solve the important and structural congestion at the Link. In those cases, the only reliable solution is to invest in incremental capacity to cut at least the structural congestion.
2. Flow commitments at Fos are likely to result in very high costs for the market. A LNG shipper that would commit in flows at Fos will probably ask for a price well over the Atlantic price for LNG, since shipping at Fos will result in a loss compared to a delivery in the Asian basin. This potential tool is not viable in the current situation.
3. The conversion of firm capacity into interruptible would be a workable solution in practice. But the level of the congestion would lead to an important level of capacity turned into interruptible, with a high degree of interruption, in particular in the summer. Hence, it is unlikely to see a shipper buying interruptible capacity if it is interrupted most of the days.

Contractual tools will not bring visibility over the forward curves. It is likely that under the provisions, the forward curve in the North will not simply be extended as it is in a wider GRTgaz zone.

Hence, GM&T Ltd thinks that **dealing with the congestion in priority with contractual tools should not be considered as a permanent solution for the merger of GRTgaz North and South zones**. The use of contractual tools as an interim solution is possible but will need further work to appreciate the costs and way it will work practically.

Do you agree with CRE's analysis?

Partially.

GM&T Ltd agrees on CRE's analysis that contractual tools could be used as a permanent solution for the merger of GRTgaz North and South for the reasons expressed above.

Regarding the use of these tools during an interim period, details on the modalities of implementation are still not clear, both on the nature of the tools and the implied costs. Further details on these issues would be much appreciated before a definitive decision on the implementation of contractual arrangements as an interim measure.

Question 4:

In the current context, do you think it is relevant to engage such investments are in view of the expected benefits?

No.

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Obviously, the full investment option will solve all congestion issues, and ensure a merger of GRTgaz North and South balancing zones without taking the risks to face restriction at entry points or expensive contractual mechanisms.

However, the full investment solution is not viable because:

1. The time horizon to have this solution fully in place is way too far. In 2020, it will probably be too late to give a proper solution to the North-South congestion and shippers will already have lost interest in going in GRTgaz South and TIGF, no matter if the merger of these 2 zones will already effective or not.
2. The proposed solution would imply an important increase in the transmission tariffs. This increase, if it is applied uniformly to all transmission components, would dramatically reduced shippers appetite for trading at the future PEG GRTgaz. Moreover, it would also create a entry barrier for small shippers to develop a sustainable retail business in France.

In any case, costs of investments will need to be applied to exit tariffs downstream of the PEGs only.

CRE and GRTgaz should not forget that before being able to trade at the PEG, a shipper needs to flow gas into the French network. Any increase of the entry capacity component will decrease a shipper's appetite for trading at the PEGs, because the costs faced to import gas in France would not be covered by trading and supply activities. Liquidity would hence drop and, considering that the EU Third Package places markets at the centre of the overall functioning of the network (especially through new balancing rules), we face the risk to destabilize the network, bringing operations at risk.

<u>Question 5</u>:

What do you think about a solution combining investments and contractual mechanisms?

GM&T Ltd thinks that this solution is the most likely to satisfy the pursued goal of economic effectiveness for several reasons:

1. The mixed solution would resolve the majority of the physical congestion whilst limitating the costs.
2. The impacts on the transmission tariffs would be limited, and may not hamper shippers appetite to get into France.
3. The additional contractual mechanisms could boost liquidity if enough shippers will be able to provide the service to GRTgaz

However, GM&T Ltd would like to warn on the limits of such a solution. The mix of investment and contractual tools will only be economically efficient if the balance between the two is set accordingly. In particular, a sufficent amount of the structural congestion must be removed. Considering that the modelling a congestion is complex and that the outputs of the model are highly sensible to the assumptions, GRTgaz should be careful in the design of the "Artere de Bourgogne". Especially, criteria for an investment decision should be:

1. A sufficient amount of congestion should be removed
2. The remaining amount of congestion to be removed should be limited so that it is dealt with on a short-term basis.
3. The overall approach should be performed under the objective of cost effectiveness

Again, costs of investments should not apply uniformly to all transmission tariffs components. The benefits of such a merger will go first to end-users in the south of France. Therefore, the increase in transmission tariffs should apply to exit components of the tariffs and not entry components.

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<u>Question 6</u>:

Do you agree with CRE's analysis concerning the creation of a joint GRTgaz South – TIGF PEG?

Yes.

GM&T Ltd share most of CRE's analysis, especially on the fact that:

- The merger of GRTgaz South and TIGF will benefit less to the French market than the GRTgaz North-South merger.
- It will not help to resolve the congestion between the north and the south of France.
- Costs of IT evolutions will probably be reduced if GRTgaz and TIGF work together on a common platform, independently from the mergers. It will also be much more comfortable for shippers to work on a single platform for both TSOs than having to deal with separate system.

<u>Question 7</u>:

Do you think that market coupling could be an alternative to the creation of a single GRTgaz North and South PEG?

No.

The level of the North-South spread experienced since the third quarter of 2011 is mainly due to a structural lack of gas supply in the South zone, through very low LNG deliveries. Hence, the impact of an extended market coupling mechanism will be limited.

A disproportionate amount of capacity allocated through market coupling could in fact have the adverse impact. If available long term firm capacity is reduced dramatically to allow an important amount of capacity to be made available through the market coupling, some shippers would necessarily need to rely on the market coupling to get capacity for the supply of their clients in the South.

Hence, they would need to bid above the market price of the capacity to be sure to get it and ensure compliance over continuity of supply. Finally, these over-the-market bids will increase the North-South spread and have the adverse effect than what CRE is expecting.

The allocation of firm long-term capacity should remain as a top priority.

Do you think that market coupling could be an alternative to the creation of a single GRTgaz South and TIGF PEG or a first step to a common PEG?

Not as a permanent solution.

There are several reasons for which a market coupling mechanism between GRTgaz South and TIGF will not virtually lead to a merger:

1. Despite the creation of a market coupling mechanism, there will still be the need to be balanced on both zones, and it will still be difficult to find gas on both markets to be balanced.
2. Access to end-users in TIGF can't rely only over a day-ahead capacity mechanism
3. It will still be complicated to get gas in the South zone. Access to capacity is one thing. Access to gas in order to use the capacity is another thing.

If so, how could a possible zero price coexist with the current price of firm booked long-term capacity at the GRTgaz South-TIGF interface?

This question has no real ground to be addressed.

Shippers committing in the long-term for capacity at this point are basically buying the certainty to ship gas between the zones, at a regulated price totally independent from the wholesale market.

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On the other hand, a shipper relying only over short-term capacity mechanisms such as market coupling may end-up paying zero for the capacity if the spread between the 2 zones is zero, but they also take the risk to have to pay more than the regulated tariff.

As a conclusion, these discussions shall not be held now but as a part of the implementation of the CAM Code, that should start as soon as possible.

Question 8:

Do you agree with CRE's comparative analysis of the various possible options?

Yes for a part of the analysis, but GM&T Ltd would like to add some thoughts to the discussion.

GM&T Ltd agrees on CRE's analysis regarding the full contractual and the full investment solutions, as already stated respectively at questions 3 and 4.

GM&T Ltd takes into consideration GRTgaz remark on the fact that it will be very complicated for them to manage the network without Eridan and the Arc de Dierrey. Considering that GRTgaz is the only party able to judge on this point, CRE should follow their advice and eventually merge the zones as of 1st April 2016, and not 2015.

Question 9:

Do you agree with CRE's analysis?

Yes.

Do you think that the TIGF PEG can continue to operate on its own in the long term?

No.

Do you think that a merger between the TIGF PEG and the Spanish market is a possible option in the short or medium term?

No.

TIGF zone should not be integrated to the Spanish market at any point in the future. It would lead to misunderstanding on the national legislation to apply in the zone and would need deep changes in both countries, or at least a special regime which is not an accurate solution.

Question 10:

Do you agree with CRE's analysis on the possible target options?

Yes, in terms of target.

Which of the three targets do you prefer?

Our preference would go to the first proposal, a single PEG France that would group the current 3 PEGs.

Question 11:

Do you agree with CRE's analysis of the need for rapid change in terms of market's structure?

GM&T Ltd acknowledge that a consolidation of the PEGs is likely to help the development of the French market. However, if a decision is taken to move forward and consolidate the current structure, the CRE should at least:

1. Collect GRTgaz thoughts on what is achievable by 2015, under the assumption that operations in the wider GRTgaz zone should not be affected by the merger. In particular, GM&T Ltd noted GRTgaz called

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for a move on 1st April 2016, after the completion of important investments inside the network that would add linepack and help managing the network

2. Held additional workshops on the contractual tools that would be implemented as an interim solution.

Do you believe that the first changes should be made by 2015 at the latest?

No.

But it would be a positive signal sent to the market.

Question 12:

Do you agree with CRE's analysis on the possible changes by 1 April 2015?

Yes.

The creation of a unique PEG GRTgaz has our preference and should be treated as a priority. Work on the resolution of the governance issues between GRTgaz and TIGF should start in parallel.

In the event of a single GRTgaz PEG, would the implementation of market coupling between GRTgaz and TIGF have to be decided at the same time?

No.

The creation of a market coupling mechanism between GRTgaz South and TIGF should be performed after a deeper analysis of the implications and further work on the details should be performed at *Concertation Gaz.*

In the event of a merger between that GRTgaz South and TIGF PEGs, would studies for the doubling of the Burgondy line have to be launched at the same time?

This study should be launched no matter the decision on the consolidation of the PEGs.

I hope you find these comments useful. If you have any queries, please do not hesitate to contact me at maxime.bourgeon@gazprom-mt.com or on + 33 1 42 99 73 73

Yours sincerely,

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