BOOK REVIEWS

The German Path to Natural Gas Liberalisation: Is it a Special Case?, by Heiko Lohmann. (Oxford: Oxford Institute for Energy Studies, 2006) 183 pages, ISBN 978 1 901795 47 9 paperback.

I wonder whether this interesting and well-written book needs a slightly different title – "The German Path *towards* Natural Gas Liberalisation." The book covers events in the German gas industry between 2000 and May 2006. At the start of the period, the industry consisted of a large number of local distribution companies, ten regional gas companies and six inter-regional gas importing companies. "For the most part gas companies felt part of one family and not potential competitors" (p. 22), and even the entrant company Wingas may have "become part of the club" (p. 23). The book describes the efforts made by regulators, customers, and the industry to agree on rules that would allow for effective competition, with third-party access to the gas networks and storage facilities. At the time the book ends, they had still not reached this destination.

When it adopted the 1998 European Gas Directive, Germany opted for negotiated Third Party Access. The negotiations were carried out–for four years–by an association of large gas consumers (the VIK), a general industrial association (the BDI), and two associations of gas companies (the BGW and VKU). They failed to reach a sustainable agreement, since the gas companies wanted an access model based on path-dependent contracts (subject to having available capacity), the VIK wanted the more flexible entry-exit model, and the BDI was apparently most concerned with avoiding a regulated solution. The negotiations finally broke down when it became clear that the government would be required to impose regulation by the 2003 Gas Directive.

The German government was a passive observer during these negotiations, but DG Comp of the European Commission was able to negotiate improved access agreements with three of the importing gas companies, following a complaint from Marathon's Norwegian affiliate. One of these settlements – with BEB (which was soon to become a pipeline and storage company without trading interests) – was based on an entry-exit model. If there was available capacity at an entry point and an exit point (each with its own charge), then it was up to the network owner to move gas between them. In contrast, the path-dependent model permits transfers only if capacity is available for the specific route required, is much less risky for the transmission company, and much less transparent. New gas shippers did learn how to operate within this system, but the complexity of doing so was a significant barrier to entry.

The 2003 Directive required Germany to have a regulator by July 2004, but the necessary law was only passed – after last-minute negotiations under the shadow of an imminent election – in July 2005. The law imposed an entry-exit tariff, in principle covering the whole country, but had to be implemented via an ordinance provision on network access. This contradicted the law, as it gave individual system operators the ability to create sub-systems and refuse transmission across any bottlenecks between them, greatly reducing the flexibility of the entry-exit system. At the time that the book was finished, these contradictions meant that the BNetzA, the new regulator, had not been able to impose a regulated-access model.

Network access was not the only barrier to competition in the German gas industry. Ruhrgas had been "the head of the 'German gas family'" (p. 127), controlling (with two of its shareholders, ExxonMobil and Shell) 90% of the wholesale market and the inter-regional transmission system. When it was taken over by E.ON, (against the wishes of the Federal Cartel Office), the German government required E.ON and Ruhrgas to dispose of stakes in many (but not all) other gas companies, to release buyers with long-term contracts from 20% of their obligations, and to auction gas to competitors. The author describes most of these steps as ineffective in creating competition (at least in the short term), and explicitly does not judge whether the takeover should have been allowed. I suspect, however, that he thinks it has been beneficial. BP, ExxonMobil, and Shell (all former shareholders) have started to change their strategies in Germany, and Ruhrgas is now a company that needs to make a profit, rather than "the keeper of the overall economic interests of the German gas industry" (p.127).

Long-term contracts for a high proportion (or all) of the buyer's requirements were another barrier to competition. As soon as liberalization started, there were suggestions that these contracts were incompatible with competition law, but no final legal judgment was reached – two cases were settled by the defending gas companies just before they reached the High Court. The Federal Cartel Office took over the task in 2004, investigated a large number of contracts, and proposed changes to limit the duration of contracts covering more than 50% of a buyer's needs. At the start of 2006, it ordered E.ON Ruhrgas to change its contracts to meet these conditions, and the company started a legal appeal that was still on-going when the book was completed.

Shortly afterwards, however, the Düsseldorf Higher Regional Court supported the Cartel Office in declaring these contracts illegal. By the end of 2006, the Federal Network Agency had also imposed the entry-exit model for gas transmission, without legal challenge. At the wholesale level, a trading hub has developed on the E.ON Ruhrgas network, with 800 GWh/day traded in January 2008 – far below the volume at Great Britain's National Balancing Point (which was 24 TWh/day in January 2007), but growing very rapidly. In other words, the conditions for more open competition in the gas industry were at last in place. This does not mean that competition will happen, however. In March 2008, the Federal Cartel Office opened a market case against 35 gas companies it accused of charging excessive prices, commenting that the extent of competition to serve household and commercial customers was "shockingly low."

The German gas industry is well worth keeping under observation. The author of this book is a journalist who has been following this saga throughout and clearly had excellent access to information – when he writes that an (interim) negotiated access agreement "was signed by representatives of the VIK who looked as if they had been eating lemons" (p.31), I infer that he was present at the ceremony. I hope that his day job will soon allow him the time to write a second edition of this book, to bring the story up to date.

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