

EUROGAS RESPONSE TO PROPOSED SECURITY OF NATURAL GAS SUPPLY DIRECTIVE

Eurogas has considered the proposed Directive on Security of Gas Supply. Eurogas agrees that security of gas supply, so vital for Europe's economic interests and the welfare of its citizens, needs to be discussed with a view to its most efficient delivery and any necessary enhancement in the expanding market. Eurogas, however, does not accept the premise that because of structural changes, additional internal market legislation is necessary on top of the revision of Directive 98/30/EC now before the European Parliament for a Second Reading and to be implemented by 1st July 2004. The Commission's analysis underestimates the dynamics of the market and the positive effects on security of supply. Implementation of the Directive's proposals could weaken the ability of the market participants to meet security of supply objectives.

INTRODUCTION

1. Eurogas agrees the importance of examining the implications of these changes in the gas market for security of gas supply, and considering how resulting challenges are to be met*. Eurogas identifies a number of points which should underpin the dynamics of gas security.
 - Security of supply is best delivered through properly functioning energy markets, sending clear price signals to all market participants. Security of supply has to be a shared responsibility taking into account that there are several actors in the market, with different objectives.
 - Gas production, supply, and transport companies will continue to play the main role in delivering security of supply because they have a fundamental economic interest in competing successfully with other energy sources, and developing the gas business. The commitment of these companies will ensure the challenge of meeting security of supply requirements is shared along the gas chain. It should primarily be the supplier's decision how to do business in a competitive market where to seek consumer market expansion and when to deliver gas in competition with other fuel and other gas supplies.
 - Spot markets and the introduction of more flexible contract formulas will enhance choice improving the liquidity of the market, alongside long-term contracts which will play a very important role; this combination will ensure that suppliers can offer security of supply as a competitive element. Levels of risk and commercial uncertainties, however, may be higher; as far as possible market participants should

* In June 2002, Eurogas issued a Position Paper Security of Gas Supplies Markets, Principles, and Actors. This paper acknowledged that because of structural changes in the market the approach to security of supply issues would also evolve, and explored how market participants should respond to new challenges in line with commercial and entrepreneurial objectives.

be confident that their investments can yield long-term returns in a stable market, with a rate of return commensurate with the risk.

- A distinction, however, is necessary in the supply security approach to domestic/smaller customers and large customers. Large customers should be free to choose their own level of supply security based on their knowledge of the commercial and technical options available to them. Households and smaller customers may need some protection beyond what is normally provided for consumer protection.
 - In a regulated system, the regime must provide adequate returns to permit TSOs and DSOs to maintain an efficient and safe infrastructure in a competitive market. The regime should also clarify the role which regulated networks have in contributing towards security of supply.
 - In any system, security of supply must be based on entrepreneurial responsibility.
 - Reliable long-term supply and demand forecasts for the EU will become even more crucial in supporting management decisions on investment.
 - Setting the legislative framework for security of supply remains a matter of national policy. Member States Governments should take adequate measures to assure that their energy policy is carried out in the general interest.
2. Eurogas accepts the EU should have a non-regulatory monitoring role on security of supply issues and should ensure that different approaches on security of supply do not introduce market distortions. The EU can facilitate market development by fostering stable political relations with gas producing regions outside the Community, and promoting a sound investment climate.

Eurogas Global Views on the Proposed Directive

3. In the light of these key principles, Eurogas has concerns about the approach of the Directive. The issues raised by the proposal have to be analyzed in greater depth in dialogue with the stakeholders. Furthermore although the proposal says it aims to ensure continuing security of supply alongside the development of the internal market, the regulatory approach outlined could be counter-productive to market solutions.
4. Eurogas also refers to the reported debate on the legal basis for this Directive. Eurogas has major doubts about the choice of Article 95 of the Treaty as a legal basis for the Directive and the establishment of the Commission's competence on security of supply matters.
5. Eurogas affirms that:
- Reserves that could supply the market are robust. There is no fundamental problem connected with increased dependence on natural gas. Gas importation is not a difficulty in principle and should not be viewed as a strategic danger. Therefore the reasoning in this respect and the consequent provisions are open to criticism.

- Open markets, effective liberalization in which the responsibilities of the different market participants are clear and a sound infrastructure will deliver greater security and efficiency of gas supplies. The market framework should incentivise investment, encouraging new production and infrastructure development. The proposal does not contribute to these objectives. On the contrary, the Commission's proposed new competence allowing them to intervene in the market is likely to distort incentives for market participants and would therefore diminish the effectiveness of the market in providing security of supply.
- All security of supply measures will have costs attached. The proposed Directive does not provide for this aspect.

COMMENTS ON THE DIFFERENT ELEMENTS OF THE PROPOSAL

Measures and Security of Supply Standards (Art. 3 & 4)

6. Eurogas can agree that Member States should be encouraged to develop in consultation with gas companies output related objectives on security of supply. The requirements, however, mentioned in Article 4 1-3 are impractical and inappropriate for several Member States.
7. Also, the proposal specifies that they are to be set with reference to the whole customer base except those with fuel switching capabilities. In a competitive market, any special protection should only cover small customers, since the position of large users is quite different. Large users will be assumed to have more knowledge on security of supply aspects including the commercial and technical options the market offers. They should not require the same level of protection as small consumers.
8. Furthermore, the wording of Article 3.4. referring to "supply standards for gas supplies for power generation" is unclear. While Member States should monitor the security of power supplies it would be inappropriate for the EU to encourage interference with the commercial decisions of power plant operations to build dual firing plant or to negotiate interruptible contracts. These decisions must be left to market participants otherwise there will be uncertainty and market distortions.
9. Any general guidance at EU level should be in accordance with the principle of subsidiarity. An attempt to harmonize or standardize requirements as well as of instruments could lead to non-optimal solutions.

Exemptions for small companies and new entrants (Art. 2.3 & 4, 3.6, 6.2)

10. Security of supply policies must be compatible with the internal market and not constitute barriers to market entry. Policies and measures have to be non discriminatory. The proposed exemptions for new entrants and small companies would lead to discrimination between incumbents and new-comers as well as between differently sized companies.

Reporting and Monitoring Procedures (Art. 4.5, 5)

11. Monitoring and transparent reporting are important, but these should be focused on the achievement of agreed goals and any difficulties in meeting these. They should not undermine or negate the responsibilities appropriate to Member States, nor impact on the management of companies. The framework for the reporting procedure has already been established in the Directive amending the current gas and electricity Directives.

Long-Term Contracts (Art. 6)

12. Eurogas welcomes that the proposal recognizes the importance of long-term contracts in Europe's energy supply, but:
 - setting the definition of "more than one year" will not meet the objective, since that would not be "long-term". It should be left to the market to decide on the duration of contracts. Long-term contracts in practice are usually from ten to twenty years. The definition should reflect this;
 - the approach appears to overlook the equal importance of long-term transport contracts and long-term transport provision.

13. Also the thinking behind Article 6.1 needs to be explored. Promotion and monitoring of market liquidity is important, but the possible supposition that there could be an insufficient degree of long-term contracts (especially if long-term is more than a year) is not well understood. Contracting future supplies is a decision of market participants.

Non discriminatory authorisation procedures (Art. 7)

14. Eurogas agrees that facilitating authorisation procedures to build new storage or LNG facilities would benefit security of supply objectives. The same would be true regarding new pipelines, especially interconnectors and new supply lines.

Action in case of an "extraordinary gas supply situation" (Art. 8)

15. It should be clarified what is envisaged by an "extraordinary gas supply situation" Art. 8.1. Eurogas is concerned that the Commission could apparently act on its own initiative, without Member States' agreement (Art. 8.3) and considers that the measures planned to respond to extreme and unlikely situations would turn out to be legally, technically, and commercially unworkable.
16. Envisaged redistribution of gas throughout the EU, in the event of an "extraordinary gas supply situation", presupposes that gas (releases from storage) and capacity (provision of pipeline capacity) are available. If so, markets following price mechanisms and international companies can respond more quickly and efficiently than any public authority. Intervention by the Commission would discourage investors.
17. A better approach to the issue would be to ensure that companies which already deliver a very high level of supply security and Member States have agreed procedures with each

other in the event of a crisis. Co-operation on this level would obviate the need for the Committee provided for in Article 9.

Proposed European Observation System (Art. 10)

18. Apart from the emergency procedures in Art. 10.3c, other points in Article 10 are covered by the other monitoring and reporting procedures. In addition, the Commission already has a role in monitoring implementation of the internal market (Art. 10.1), and there is the Madrid Forum and the Energy Transport Forum. Eurogas is not convinced of the need for this new body.

Monitoring of Access to Storage and Possible Further Proposals (Art. 11)

19. This issue is covered by the Amendments to the Gas Directive 98/30.

CONCLUSION

20. Security of supply is best provided through efficient and properly functioning energy markets sending clear signals to consumers, investors, and national authorities. The proposal underestimates the dynamic potential and driving forces in the market, and some elements in the proposal could have the effect of unnecessarily distorting the competitive market, EU policy states it is putting in place.