

THE EUROPEAN GAS MARKET: EUROGAS VIEWS ON THE WAY FORWARD

In the ongoing discussion on energy in 2006, Eurogas considers it is timely to reassert the importance of the gas industry in contributing to a sustainable energy supply for Europe. Recently questions have been raised about increasing dependency on gas, including for electricity production, and concerns have been expressed because of security of supply considerations. It is important not to be complacent. Changes in the supply structure and considerations arising from world economic growth are bringing new significant challenges.

Eurogas, however, recalls that gas reserves are abundant and commercially accessible. Provided that external policy, market and regulatory frameworks are in place to keep Europe an attractive destination for the world's gas supplies then gas can make a decisive contribution to building a bridge to a more sustainable energy future for Europe.

The world is currently experiencing a considerable growth in energy demand, and growth in gas demand is particularly strong. Gas is forecast to become the second most important fuel from 2020. Power generation is and will remain the main driver of the growth in gas demand, even if the present gas price level raises some uncertainties about the most bullish forecasts, especially when coupled with the debate about future environmental regulation, emissions trading, technology developments and the future contribution of nuclear. It is certain, however, that gas penetration in the global market will grow. Fortunately, **gas reserves are abundant worldwide, although they are mainly concentrated in two areas, Russia and the Middle East Region.** Therefore growth in world gas consumption will imply higher reliance on large scale development of international trade, long distance transportation, with special expansion of LNG trade, and critically, underpinning these, realisation of major investments.

Europe will be one of the important world areas competing to gain access to these concentrated gas reserves. Because gas consumption in Europe is increasing, but also because European domestic gas production is in decline, it is important that Europe can remain an attractive zone for new gas imports. **European gas companies will be required to meet the challenge of filling an increasing supply gap at the same time as appetites for gas in Asia and the United States are rising.**

Today Europe is fortunate to be surrounded by three major producers (Russia, Norway and Algeria), with large reserves accounting for half of its supplies. Alongside these giants, European gas companies are developing diversification of supply sources and routes: contracts have been signed with Libya, Egypt and Qatar and Nigeria; others may come with Iran. **The potential, however, for diversification is limited and given the decrease of domestic production, the outstanding position of the three major producers will not change much in the coming years.**

LNG development encompasses some very specific features, **it increases the diversification options, it paves the way for more flexible supplies** which also means spot gas prices will be the decisive criteria of destination for spot LNG cargoes. LNG trade linked to long-term contracts has proved effective in developing the infrastructure along the whole supply chain and has provided security of supply. The flexibility associated with spot trade, rerouting possibilities and excess terminaling capacities could bring optimisation opportunities.

Gas market liberalization is profoundly changing the structure of the industry. Customer choice and the evolution to gas-to-gas competition have obliged companies to rethink their strategies, restructure their operations, develop new services and become more efficient. Effective unbundling gives network-users confidence their requests for network access and development will be treated in a non-discriminatory manner.

But unbundling challenges previous approaches to investment decisions, the regulatory framework has not yet fully stabilised and competition development introduces some uncertainty on suppliers' future market shares. All this at a time when heavy, long term decisions, whether to build large infrastructures, whether to take large purchasing commitments, have to be taken to guarantee the security of supply of the European market. **To assess and make commitments on these large investments, market participants need to have access to the necessary information and confidence that a fair, clear, and stable allocation of risks and responsibilities has been established.**

In this context, some European gas companies - still relatively fragmented in comparison with few very powerful and often state influenced up-stream supply companies- seek to spread their risk by diversifying and entering markets in other Member States, embracing new market opportunities, having in mind also to respond to the ambitions of upstream producers to be active on the downstream European gas market.

Industry consolidation has raised questions regarding its effect on competition and on how to preserve the interests of Europe's consumers, including the right to have a real choice of energy supplier among a range of competing large and smaller supply companies and traders able to meet customers' differing needs at competitive prices. Providing this consolidation is in line with competition rules, it will bring benefits to European consumers and in addition contribute to the strengthening of the purchasing power of Europe as a whole.

Eurogas supports the achievement of the internal gas market. A fully functioning internal market will enhance efficiency in the customers' interests and contribute to security of supply. Customer choice leading to effective competition should bring innovation in offers and services, including energy efficiency services, and drive technological development, to improve Europe's competitiveness. Considerable progress has been achieved since the adoption of the first Gas Market Directive in 1998, but further efforts are necessary. Eurogas is keen to see improved progress and urges Member States to ensure all elements are in place to meet the 1st July 2007 target date for full market opening. **Timely and correct implementation of existing legislation and regulation and fulfillment of voluntary commitments is the immediate priority.**

The focus has to be put on achieving further European market integration and in this respect getting the regulatory framework right presents a challenge. The paper suggests some approaches to tackle these challenges. From the suppliers and users perspective, it is essential that the rules are in place to ensure non-discriminatory access based on appropriate tariff structures, as well as capacity allocation and congestion management rules to optimize use of existing capacity and give market signals for needed new capacity. System users must be able to move their gas through networks in a fluid way on an economic basis. **Transparency and coherence of rules leading to convergence of operators' services will be keys to further progress but a lot of detailed, pragmatic work is required to ensure removal of all obstacles.** Therefore Eurogas participates actively in the Madrid Forum which seeks to find consensus-based solutions on a range of access related issues covering tariffs, capacity, interoperability, and looks forward to contributing to the planned work of

ERGEG on regional markets which can provide a useful next step to a fully integrated European market. Ways also need to be explored of improving the regulatory process.

Eurogas recalls that climate change and other environmental concerns present a significant challenge for Europe's policy makers and considers the qualities of gas have made it a fuel of choice to provide part of the solution in the energy mix. The policy framework, in particular by supporting industry's drive towards technological developments and research and development to improve the efficiency of gas applications should be supportive.

Eurogas supports the objective set out in the Energy Green Paper of meeting the inter-related and parallel objectives of a fully functioning energy market, secure supply and an environmentally sustainable fuel mix. **European consumers will be best placed to enjoy the benefits gas brings in a competitive gas market, only if security of supply to the market is assured.**

So, beside the above considerations on the functioning of the internal market, our key messages on the way forward are very much focussed on how security of supply can be delivered within a fully functioning internal market, exploiting the environmental qualities of gas.

- Each country has developed and should retain responsibility for setting its national security of supply standards within principles set by the Directive safeguarding Gas Security of Supply. **It is important, however, that some level of Europe-wide coherence is developed for example to promote and facilitate diversification of supply, while ensuring that national security of supply standards are compatible with the development of an internal gas market.**
- Negotiation between suppliers and sellers at industry level was and is the fundamental basis for organising European gas supply. **But it is very necessary that this relation be supported by solid political relations, in bilateral and most importantly European dialogues between consumer countries on the one hand and producing and transiting countries on the other hand. This political dialogue has to be supportive of the efforts of the European gas industry.** In today's world, energy is a geopolitical issue that cannot be resolved by market dynamics alone although these must continue to be promoted along the supply chain. It is necessary for Europe to speak with one voice in a global energy market.
- Large investments are necessary to bridge the gap between supply and demand; these include not only investments in distant production zones but also massive investments in Europe for transmission and gas storages. Therefore a policy framework is needed that recognizes the necessary long-term requirements and provides appropriate incentives, and **it should be a priority of the European agenda to facilitate these investments in support of all the actors involved in these projects** (financing institutions, producers, buyers, infrastructure developers, etc.). **The impact of the regulatory framework is crucial in this respect** since appropriate exemption mechanisms, the long term rate of return allowed for regulated activities, the stability of regulations, stream-lining of planning processes all play a part in ensuring the necessary infrastructure and facilities are in place.

- For suppliers, **long term take or pay contracts should remain crucial and for most companies indeed will be the backbone of their supply strategies** not only for their contribution in securing investments along the whole gas chain by the predictability they give, but also because they tie together buyer and seller with a mutually acceptable balance of risks.
- At the same time a **more liquid market supported by shorter-term contracts, spot, and hub development, has to be achieved** to complement longer-term arrangements, widen supply options by improving flexibility and enhancing portfolio optimisation.
