

## **VIEWS OF EUROGAS ON AN EU SECURITY AND SOLIDARITY ACTION PLAN**

### **Introduction**

Eurogas welcomes the Commission's package focused on actions to improve energy security, solidarity, and energy efficiency. The gas crisis this year has reminded us of the importance to the wellbeing of Europe's citizens and to economic interests of a secure gas supply.

Worldwide gas reserves are abundant and commercially accessible. Provided that external policy, market, and regulatory frameworks are in place to keep Europe an attractive market in a world marked by increasing global competition for gas, and the needed investment is realized, then Eurogas is confident in gas supplies meeting future demand in Europe. Moreover, recent events notwithstanding and certainly every step ought to be taken to prevent future disputes between Gazprom and Naftogas disrupting Europe's supplies, Eurogas considers that gas producers and supply routes to Europe are reliable overall. Even, however, before the recent crisis measures to enhance security of supply were identified, and now lessons can and have to be learned from the crisis, with the objective of determining appropriate preventative and response measures when these are needed to support market mechanisms.

Principal elements of the approach to security of supply should cover the following:

- Further development of the internal gas market is needed, with improved trading liquidity, interoperability and interconnections to enhance the security of individual Member States as well as Europe as a whole. It is a matter of concern that some Member States are not connected to the main European gas grid or have available only limited interconnection capacity. Possibilities to connect isolated Member States to the main EU gas grid must be investigated as a priority.
- Diversification potential, both of producers and supply routes to Europe, has to be improved.
- Therefore investments are needed in pipelines to Europe and within Europe, and also in LNG terminals/facilities.
- Increased investment in commercial storage over and above that in progress or planned is also essential, as this will not only contribute to short-term market flexibility, but improve security of supply in the longer term.
- Although it is the companies' responsibility to conduct commercial relations with producers, it is important that the EU strengthen energy dialogues with producer and transit countries (current and future). The dialogues should provide a framework for increased co-operation on a range of issues, and be aimed at achieving necessary political assurances from the countries concerned.

Eurogas also welcomes the package's emphasis on an integrated approach to be taken to energy security policy. Eurogas is, however, concerned that the gas demand scenarios referenced in the package overestimate the foreseen market displacement of natural gas (see Annex 1) in comparison to general understanding on its medium-term role. This could lead to uncertainties in planning for investments on which there is a strong consensus on their importance. Eurogas considers that natural gas demand will continue to rise (although probably at a slower overall rate, than in past years) because of its high performances in terms of thermal efficiency, operational and commercial flexibility and emissions control.

The effective implementation of energy efficiency will contribute to supply security goals and at the same time offers the most cost effective way to reach climate change targets through a combination of energy savings and a fuel-switching trend towards more CO<sub>2</sub> friendly energies and technologies, to which objective natural gas can contribute. Transparency and analysis contributing to shared forecasting exercises is necessary to develop a balanced policy framework that will contribute to security of supply objectives.

The five points of the proposed EU Energy Security and Solidarity Action Plan represent a sound basis for discussion and further development. Below Eurogas comments on the five points and identifies for each its own proposed set of issues for the development of a coherent, standardised and co-ordinated European approach to Europe's security of supply.

### **Infrastructure needs and the diversification of energy supplies**

Eurogas welcomes the package's highlighting of the need for new infrastructure, both pipelines and LNG terminals/facilities, to bring gas to Europe. Diversification of transport routes and of supply sources are an essential element of Europe's security of supply, and thus infrastructure has to be in place to meet the needs of a robust, well functioning market, geared to attract supplies that Europe needs. The internal market must provide a stable, investment friendly environment to encourage these investments which are the responsibility of the gas supply companies. We also support the review of the TEN-E policy, on which Eurogas is commenting in detail in relation to the Green Paper on Networks. As far as possible all Member States should have access to potential supply diversification which is not the case today. The lack of links potentially renders solidarity actions valueless. The Ten Year investment plan to be developed by ENTSOG should take account of the European dimension in defining projects to meet users' market needs. The Agency must facilitate through improved regulatory co-operation and co-ordination the needed investment.

In the view of Eurogas the individual pipeline projects highlighted in the Communication offer different advantages in terms of diversification potential, and because of the need to source new imports all potential pipeline projects which would further Europe's supply security and diversification should be considered recognizing that there are still questions about their economic feasibility. A formal decision has to be taken by the relevant companies, and in making their decisions they will take into account a number of factors including the likely development of the LNG market share.

It should not, however, be overlooked that there is also potential in more basic, comparatively inexpensive measures, to boost the robustness and flexibility of the European network, by improving possibilities for bi-directional flow, for example.

LNG is useful in reinforcing the mechanisms of security of supply as it provides diversity of sources, routes and flexibility. However it also implies buying gas in a global market, where most contracts are still long-term but there is a discernable trend toward shorter-term or spot, and where production is continuously seeking the highest possible margins. In that market, regasification capacity is twice the liquefaction capacity, which usually leads to high prices and implies that terminals have very low load factors, with an average of less than 50%. Given the current reductions of demand in the global LNG market and in the face of uncertain price developments, several producer countries have substantially cut their LNG production. The implications of this need to be considered in developing a number of EU level actions to help make Europe an attractive market for LNG suppliers. Eurogas has addressed this issue in a separate paper.

Section 2.1 within **Promoting Infrastructure essential to the EU's energy needs** also refers to the feasibility of a block purchasing mechanism for Caspian Gas, but does not clarify what form this could take. In the view of Eurogas, it is very important for all companies to have the market opportunities to buy and import supplies from the Caspian area. EU policies to facilitate this by putting in place with the countries political and legal frameworks are welcome.

Commercial arrangements bringing benefits to the economy and welfare of Caspian countries can then follow. In principle each individual company should be responsible for its supplies. Any approach would have to be designed to be fully competitive, non-discriminatory, and should not distort the market.

In any case throughout the approach to investment, the roles and responsibilities between companies (who have to bear the risk of investments), the Member States and the European institutions have to be clarified and be kept distinct.

### **Issues to be developed**

- To promote a more robust and interoperable European network grid that will facilitate cross-border gas flows and seamless carriage of gas for users for their day to day market needs, and can offer additional flexibility in supply options.
- To achieve the 10% of electricity and gas interconnections capacity by 2010 identified as necessary by the European Council for isolated energy markets in the 2007 Energy Action Plan.
- To promote the realisation of planned new routes bringing gas to Europe, that will enhance diversification of supply from new and existing producers, and offer varied transit routes.
- To develop a coherent and consistent package of actions to ensure that Europe can compete successfully for LNG in the global market. These actions should maximise the potential for LNG to play an important role in the internal market and include dialogue with LNG producers on enhancing production (see separate paper from Eurogas giving views on an LNG Action Plan).
- To develop measures to facilitate planning and permitting processes for major projects, whether pipelines or other infrastructure.
- To improve information on network flows, within and upstream of the European network.
- To improve exchange of information on national supply diversification policies in the Gas Co-ordination Group.
- To ensure a clear and stable regulatory framework that recognizes the need for balanced economic incentives.

### **External Energy Relations**

Eurogas agrees that Energy Dialogues with producing and transit countries and partners have to be improved, to provide a political framework conducive to sound business relations, Eurogas has already made proposals for improving the dialogues (08NO503) but against a background of global gas competition, the improvement of relations with producers has to be a key objective, reflecting unity of Member States' interests. A clear division, however, of roles and responsibilities is essential: it is not the responsibility of EU institutions to enter into negotiations with gas producers on the EU's behalf although they may have a facilitating role. Gas supply negotiations are a commercial matter for companies, acting on an entrepreneurial basis.

Eurogas also considers that the energy dialogues offer good opportunities for ensuring an understanding of the EU gas market. With our nearer neighbours, expansion of the Community's Acquis Communautaire perhaps through membership of the Energy Community should also be an objective, although this process has to avoid putting at risk developments and co-operation, and should be accompanied by liaison between the EU and countries in its neighbourhood policy framework aimed at increasing their social stability. Support for the

principles of the Energy Charter Treaty and continuing attention to the idea of a transit agreement can also have a role to play, as well as political assurances from potential transit countries.

Greater awareness of the importance of the external dimension will in principle improve the effectiveness of the EU's decisions and actions. For example, when new import projects are discussed, the emphasis should be on ensuring pragmatic, market-based and lean, non-bureaucratic processes, for their validation and promotion.

### **Issues to be developed**

- To prepare a yearly review on the status and evolution of all dialogues with third countries where energy matters are discussed; to consult with the industry in key issues;
- To recognize the benefits of linking producers and consumers' interests through upstream and downstream cross-investments as this helps create a lasting and reinforced trust between producer and consumer countries. There should be in principle no discrimination against foreign investors in either areas in line with good international practices and free movement of capital.
- As upstream engagement substantially contributes to security of supply an EU energy policy should facilitate the efforts of European undertakings to invest in the upstream sector.
- To use the dialogues to focus more on technology transfer, and involve the European gas industry in the setting up of any EU-third country energy technology platforms.
- To pursue and reinforce the Inogate programme.

Also, in a broader political context the EU should consider helping the Ukraine and other transit countries in stabilising their economic and financial frameworks.

### **Improved oil and gas stocks and crisis response mechanisms**

Eurogas agrees that there is scope for clarifying the Security of Gas Supply Directive to ensure improved implementation of its provisions, and in tandem the monitoring role of the Gas Co-ordination Group can be enhanced. Eurogas also agrees that the approach on security standards can be further developed. While standards should ultimately remain the responsibility of Member States, it should be possible to reach within the Gas Co-ordination Group a better understanding of their essential scope in qualitative terms, and as the internal market develops, to take advantage of cross-border and regional opportunities presented that can contribute to a co-ordinated approach. Eurogas will develop these ideas further in its response to the Communication on revising the Security of Gas Supply Directive.

As mentioned above, lessons can be learned from the recent crisis to contribute to preventing further crises and to help develop solutions in advance that will mitigate the impact of future supply disruptions. The responsibilities of the different market players, notably operators, shippers, and suppliers, have to be clear.

With regard to solidarity, Eurogas emphasizes that in improvements to market functioning lies the greatest potential for improving solidarity. An analysis of responses to the crisis has shown that market-based actions of companies carried out in a spirit of solidarity contributed to ameliorating the situation in Member States, subject to the possibilities offered by physical network links. Member States, however, have all to make maximum efforts to improve their own security of supply arrangements. There has therefore to be adequate transparency of measures taken at EU level. Any solidarity mechanisms should in the first place be aimed at boosting interconnections and storage capacity. Companies, Governments, regulators have all

to recognize the commercial as well as the security benefits that will flow from boosting measures to improve system interoperability meeting interdependence requirements. Legal and operational barriers to access to cross-border storage capacity on a commercial basis should be removed. LNG, because of its flexibility, also offers potential. Eurogas, however, would endorse the Commission's statement that solidarity is by no means charity. Costs have to be met and solidarity actions have to be underpinned by financial understandings.

Eurogas needs more clarification before it can endorse the extension of regulatory powers into security of supply related issues at EU level. With regard to crisis management in case of a major supply disruption a leading role of regulatory authorities seems inappropriate, since the reach of the decisions to be taken in such a situation may exceed the responsibilities that have been attributed to these authorities.

Eurogas welcomes the recognition in the package that there is insufficient evidence at this stage for the EU to decide on the need for obligatory gas storage. The prohibitive costs of such storages compared with oil stocks are correctly acknowledged. Furthermore Eurogas recalls its other arguments against an EU wide policy on strategic stock, notably that an EU-level obligation would jeopardize the development of commercial storages (08PP475). In addition, gas storage facilities may not be the least cost option for some Member States to improve security standards, not least because of difficult geological conditions in many countries. Other measures may be better to manage security concerns. It is important that an over-hasty reaction to the recent supply crisis does not weaken this objective conclusion on strategic storage. Instead the policy framework has to be conducive to the development of commercial storages that can be used as flexibility instruments crucial for the development of a competitive liquid market and can also contribute to security of supply.

### **Issues to be developed**

- To promote co-operation on border flows transparency, to permit direct monitoring of the TSO flows entering the EU. This can serve as an early warning mechanism of problems, and a basis for an analysis of needed engagement.
- To develop the role of the Gas Co-ordination Group to improve first-hand communication between network operators, suppliers, and shippers.
- To establish GCG working groups consisting of non-European transit and producing countries and industry representatives to co-operate on issues.
- To assist in working out scenarios for the management of major supply disruptions, thereby enabling Member States to assess the need for and the possible content of regional and/or bilateral solidarity agreements, as foreseen in the proposed Third Package.

### **Energy efficiency**

Eurogas welcomes the outlined initiatives aimed at promoting a further development of energy efficiency measures. Eurogas considers that it is necessary to exploit a range of tools to incentivise energy efficiency in all sectors of end-use and elsewhere in the energy chain. Eurogas welcomes that the working papers have highlighted the high-efficiency of natural gas fired power generation. Greater use of gas is therefore an environmentally attractive option for power generation, while renewables are being developed to widespread commercial scale.

CHP typically utilizes 90% of the primary energy content in the fuel, so gas can be used to improve overall conversion efficiency and at the same time – by reducing network losses and improving network stability – produce greater distribution network efficiency.

In industry, direct use of gas in combination with smart technology allows the production of high-grade goods in an energy efficient, cost-effective and environmentally friendly manner,

while in the home the use of high efficiency gas boilers – particularly in new buildings – is more than twice as effective in terms of reducing carbon emissions as converting the gas into electricity and using it to heat dwellings, once electricity network losses are taken into account. Penetration into the household and small business sector of micro-CHP also offers significant energy saving potential.

### **Issues to be developed**

- To promote gas use in power generation, both as a main fuel and as a backup to RES.
- To recognize in the ECO-design Directive and related efficiency regulations, the potential in the domestic sector of condensing gas boilers and also micro-cogeneration.
- To promote research and development of intelligent electricity grids to underpin decentralized electricity production and virtual power plants.

### **Making the best use of the EU's indigenous energy resources**

Eurogas fully endorses the EU Energy Security and Solidarity Action Plan's fifth point: making the best use of the EU's indigenous energy resources. Eurogas has the impression, however, that in its Plan the Commission, now focusing mainly on the potential of renewable energy and clean coal technology, could further elaborate the possible incentives that could be given to develop Europe's remaining natural gas reserves. Eurogas recalls that natural gas is the cleanest of all fossil fuels and that it can play an important role in facilitating the transition to a more sustainable use of energy. Moreover, biogas as a climate friendly and sustainable fuel that can be mixed with natural gas, and can substitute for it in a number of uses, should also be promoted.

Together with OGP, Eurogas believes that measures should be taken to maximize natural gas production and recovery from indigenous sources, thereby increasing economic contribution and security of supply. OGP in its May 2008 paper "Secure European natural gas supplies: the importance of indigenous supply" gives an overview of the major challenges for the development of yet untapped indigenous gas reserves. Eurogas supports their recommendations regarding the importance of stable and competitive fiscal and regulatory regimes, development of new technologies for exploration and exploitation, and world class technical knowledge and skills. Eurogas also sees scope in improving permitting and other procedures to stimulate productions.

Eurogas would like to make some additional recommendations. In some areas clear priorities should be set in relation to spatial planning, on shore as well as off shore. Remaining reserves must be produced before the gathering system connecting these reserves to the market reaches the end of its technical and/or economical lifetime. The duration of exploration and/or production licenses could be restricted, if no activities in the license area are undertaken. Potential for the future use of untapped fields as storage facilities (either for natural gas or for CO<sub>2</sub>) may constitute additional reason to create incentives for the development of such fields.

### **Issues to be developed**

- To introduce measures to simplify and accelerate permitting procedures, including removing ambiguities about the permitting authority.
- To explore ways of improving the upstream fiscal regimes to promote development of smaller fields.
- Make geological/seismic data publicly available after concession-time has elapsed, as this may stimulate the recovery of remaining reserves.
- To encourage research and development into biogas production, distribution and final use.

In the framework of the Second Strategic Energy Review (SER2), the European Commission published a "new energy policy" (NEP) scenario supposing the achievement of the current EU policies. Two price assumptions were considered a 61\$/bbl and 100\$/bbl. The starting point for the NEP Scenario has already been determined in the Baseline Scenario 'Trends to 2030', which includes policies and measures implemented up to the end of 2006. Therefore the present analysis is comparing the EC baseline scenario at 61\$/bbl with the Eurogas forecast.

The projections for natural gas demand predict that the contribution of natural gas to the energy supply of the European Union will increase in the long run (2030) from the current 440 MTOE to an amount in the range of 516 MTOE (EU) to 625 MTOE (Eurogas). Compared with the Eurogas estimate, the EU expects long-term gas demand in the Community to be about 13% to 17% lower (current DG TREN reference scenario). While the forecasts for the residential/commercial sector and industry are very similar, expectations differ quite significantly (by 25% to 40%) for natural gas use in power generation. The main reason are the coal price assumptions: In the DG TREN scenario, the price of coal is assumed to be constant in real terms over the long term, while Eurogas expects rising prices also for coal. As a consequence gas suffers competitive price disadvantages in the EU Scenario, since it is still linked to the rising oil price.

In its analysis of the scenarios Eurogas notes:

- Assessing the scenario's results the EU states that 'overall the baseline scenario depicts an unsustainable development given CO2 developments and external risks'.
- The current lack of sustainability makes clear that the SER2 needs to encourage the reduction of the use of imported primary energy and push renewable energies.
- SER2 has to be considered as a political scenario, assessing a situation in which energy policy goals are stringently enforced. This approach needs be questioned, given its possible effects on investment decisions in countries, which play a role in securing European energy supplies.
- The scenario results published in the SER2 annex are only partial as no country by country totals are available to understand the totals.
- Generally, the explanations of the assumptions, behind the different scenarios, as well as their purpose are neither well presented, nor communicated.

Eurogas would therefore recommend:

- In view of the preparation of the 2050 scenarios to ask the Commission to consult with stakeholders;
- Present detailed clarifications on the purpose and methodology used in discussions with external suppliers;
- Review the long-term outlook in the context of the financial crisis.