

Eurogas Position Paper on Joint Procurement of Natural Gas

Context

Both the Communication on More Affordable, Sustainable and Secure Energy and the Draft Regulation on Security of Supply make reference to joint purchasing of gaseous fuels: natural gas, LNG and hydrogen. The current combination of high prices in the gas wholesale market and the war in Ukraine have driven political attention on to the issue of gas purchasing. The European Commission is proposing to develop a task force on common gas purchases at the EU level, in the Communication on Security of supply and affordable energy prices: Options for immediate measures and preparing for next winter published in March 2022.

This Communication states that the EU is better placed to jointly harness the market power of its members and avoid members bidding against each other for the same resource. As announced by the European Commission on 8 April, following the first meeting of EU Energy Purchase Platform, the aim is to facilitate and strengthen EU negotiations with suppliers of LNG and gas ahead of next winter. We also recognise the recent Resolution of the European Parliament calling for a full embargo on Russian imports for oil, coal, nuclear fuel and gas. The Communication confirms that the Commission would seek better prices, through long term engagements including for renewable gases and hydrogen. These would be achieved by setting up energy partnerships with key suppliers in the Mediterranean, Middle East and Africa.

The proposal for a task force also includes the element of a steering board that would support the Commission, comprising member state representatives – inspired by the Covid-19 negotiating experience on vaccines. The task force would also be responsible for promoting the efficient use of the EU's gas infrastructure including LNG terminals, storage facilities and pipelines.

Eurogas Position on Joint Procurement

The short-term purpose of EU joint gas purchases is stated to secure gas supply at affordable prices by the end of 2022. There is, however, little expectation that joint purchasing can in the short term dampen prices given the fact that there is not a huge amount of gas from alternative sources available on the global market in 2022. Estimates suggest that under optimal circumstances we may be able to attract up to 40 bcm, mainly flexible, non-committed LNG. The market is structurally undersupplied and these volumes are subject to global price pulls and demand. Whilst in theory avoiding bidding wars between intra-European market participants, a joint procurement platform will hardly be able to corner this market, as the main competitors are not within the EU but external to it – in Asia and South America. Thus, competitive prices will have to be paid to secure gas, which cannot be precluded by joint purchasing.

Eurogas supports the negotiation and procurement of gas supplies from third countries through the utilisation of the vast experience held by the market actors, who collectively have successfully negotiated hundreds of such contracts to date.

The procurement of gas does not lend itself easily to joint purchasing in the way that Covid-19 vaccine negotiation did. This is because in the case of Covid-19 vaccines the Commission had to negotiate with three similar companies, whereas in the case of gas there are more than 30 different supplier countries, with different cultures, different expectations, different negotiating entities, different mechanisms to control resources and exports, etc. Gas procurement is complex and needs experts in the gas market to secure the best deals and organise the complex logistic chains. The EU gas companies have this experience and as such should remain the key parties in gas procurement negotiations for the benefit of the EU consumers.

Different to the precedent of joint purchase of Covid-19 vaccines, a major question relating to joint procurement is how to allocate the gas procured. Not all EU countries rely heavily on gas, while some do. It is not clear how an allocation mechanism can be set up without a major negotiation in the EU on who needs what and when they need it. Price and volumes or trajectories of the so procured gas would have to be determined before released to the market and a take or pay mechanism agreed. It may therefore not represent a short-term remedy to the current crisis situation. It also seems likely that this system could fundamentally distort, if not preclude, the market entirely and thus 30 years of gas market definition and development could be lost over night. This would be counterproductive given that the EU gas market design is considered to have created one of the most efficient markets in global energy regulation.

If high prices are the main concerns, better solutions are outlined in the toolbox by the Commission in October 2021: Support to vulnerable consumers, identifying tax relief, household support schemes, energy efficiency measures and providing solutions to help consumers reduce demand, where possible. These are immediate measures that should be continued and encouraged as a matter of urgency.

If security of supply is another main concern to be addressed, market-based mechanisms could be considered to make available to the system options, based on medium/long-term supply contracts, that ensure supply adequacy and provide medium-long term price signals.

In the long term we can incentivise alternative supply, thereby increasing the global supply and helping to dampen market prices. This implies putting financial and diplomatic support into upstream projects, both domestically and abroad, a role that the European Commission can support through partnership agreements – whilst also ensuring the necessary business visibility and providing long-term predictability for investors in those projects. Any such new investments will need to be climate compatible, including by being hydrogen ready, or by ensuring a coordinated global energy transition jointly with Europe's international partners. In any case, this approach is important as it helps maintain competition which is the means that results in lower prices for consumers ultimately.

Eliminating supply from the largest provider of gas to the EU will not easily result in lower gas prices for the EU. It is therefore hard to see how a joint purchase task force will improve the situation given that there is no vast amount of available volume on the global market and that the task force as proposed has no experience of negotiating contracts with different countries, companies and agencies. The complexity of gas contracts is notorious, everything from the type of ship to be used for LNG, to the matter of destination clauses, duration and capacity reservation on pipe or LNG delivery. These are elements that are best handled by experienced negotiators from market actors.

Joint procurement should only be seen as a last resort mechanism, for example in a regional or Union emergency, and consider the following operational principles:

Proposed Principles for Joint Procurement

1. Membership of the task force must be voluntary. Member States must be allowed to choose if they participate in the task force or not.
2. Any task force must have a broad exemption from competition laws. This is necessary otherwise the platform will be hamstrung over what elements can be negotiated in common and those that cannot. A failure to deliver exemptions from competition law will result in a poorly functioning task force.
3. The task force must be limited in time and have a pre-defined scope. Thereafter, the market should be returned to fulfilling the function of procurement of gas and hydrogen.
4. The task force must include market actors, as they have the experience of negotiating with a wide variety of third country suppliers, they understand the technical and complex nature of gas contracts - having secured hundreds in the past decades and are able to organize the necessary logistics. This skill will be vital to get the best deals for the EU through such a task force. Given the structure proposed by the Commission in the Communication we would propose that Member States and their market actors lead the negotiations within a framework set by the Commission, who would also be responsible for the overall coordination of negotiating teams and ensuring that competition rules are respected.
5. If joint procurement is to be pursued it could also be more adroit to apply this to new quantities and/or new suppliers only, which would not disrupt existing contracts. An option could be explored to enable assigning existing contracts, on a voluntary basis, to the joint procurement body where such contracts are held by market participants in a Member State that decides to participate in the joint procurement.
6. Long term contracts must also be supported where these are necessary to encourage the development of export facilities in the third countries and would contribute to stabilizing the system.

7. Releasing the procured gas to the market must happen in the least distortive way; terms and conditions must be transparent and subject to extensive stakeholder consultation.

The Key Role for the European Commission in Facilitating Gas Procurement

As the Communication rightly points out the key role of the European Commission in gas purchasing is twofold – setting up energy partnership agreements that set framework conditions for energy relationships between countries and the EU; and the development and promotion of critical gas infrastructure that will be needed.

These are the two key elements that the Commission can deliver and that have been reinforced following the first meeting of EU Energy Purchase Platform on 8 April. Firstly, setting up long term energy partnerships with exporting third countries is of great importance – these should set the overall tone for relationships with the EU and gas suppliers from those countries. Such partnerships should also demonstrate the vital role of gaseous fuels in helping to fighting climate change, by including provisions on the development of renewable and low carbon gases and the reduction of methane emissions in third countries for export to the EU. These partnerships will provide the political level support for actual contracts to be developed between EU market actors and the suppliers in the third country.

The other key element is that the European Commission must urgently review the gas infrastructure that is available for this gas flow switch and quickly determine what new infrastructure is needed. This should apply to LNG terminals, new infrastructure to connect new terminals, storage facilities and interconnectors. A report should be drawn up and, where necessary, EU funding for this new gas, and hydrogen ready, infrastructure should be directed accordingly to support gas companies to develop such sites.