Eurogas discussion paper on LNG

29 September 2023

Objective of this document

This document aims at addressing the critical points raised during the CEER/CNMC 37th Madrid Forum presentation. In particular, the document develops Eurogas observations on the new role of LNG in Europe, the integration of emergency measures in the regulatory framework and explore potential improvements for the current regulatory framework (TPA exemption, transparency, allocation of capacity, tariffs discounts). Previous relevant Eurogas public positions:

- E.U. – U.S. LNG Industry Joint Statement of Support and Recommendations for the Achievement of the RePowerEU and U.S. – E.U. Energy Security Taskforce U.S. LNG Targets
- Eurogas 37th Madrid Forum intervention – 02. Policy update and 08. LNG session

I. The new role of LNG in the EU

Until 2019, most of EU did not need LNG as a baseload source, only ordering cargoes if spreads with other global markets were favourable or in case of temporary demand/supply imbalance. Due to the Russian invasion of Ukraine, Russia's role significantly decreased to the advantage of LNG supply routes, with LNG now being more of a baseload supply[1].

In light of this increased amount of LNG being imported, the EU has seen an increased use of its regasification capacities[2], still continuing in 2023. Numerous investments have been made to deploy LNG infrastructure in the EU. As of Nov. 2022: 22 operational LNG import terminals, with a capacity of 169 bcm/year. Post-2022[3]:

- 7 import terminals (new or expansion) are under construction with a capacity of 17 bcm/year (out of which 11.5 in 2023, 3.9 in 2024, 1.8 in 2026).
- 23 import terminals are planned with a capacity of 101 bcm/year (out of which 31 in 2023, 12.8 in 2024, 13.3 in 2025, 12 in 2026, 2.6 in 2029, the rest with no set date yet).

Ensuring the attractiveness of the EU market for LNG, notwithstanding if spot, mid or long term, is the core challenge to overcome.

II. Role of LNG to replace previous Russian imports

Discussing the role of LNG contracts covers two interlinked challenges:

1. How to ensure Security of Supply (SoS) in Europe?
2. How long-term contracts would align with the EU climate ambitions?

The ability to sign longer term contracts directly impacts the attractiveness of the EU market for LNG. Multiple countries noted that the long-term predictability of the EU gas consumption was of concern; Qatar has been vocal about its preference for long-term contracts of 15/20 years[4], Norway noted that post-2030 demand was casting doubts on further investments necessary to maintain

[1] European natural gas imports, Bruegel
[2] European Commission Quarterly report on European gas market – Q4 2022
[3] GLE, LNG Database
[4] Reuters – German utilities close to long-term LNG deals with Qatar, sources say (September 2022)

production[5] and Canada noted the necessity of a "*business case*" for Europe[6]. Yet, the EU has not provided clarifications on the projections of natural gas consumption foreseen by the European Commission taking into account diplomatic statements and replacing the forecasts in the Staff Working Document with realistic figures for both 2030 and 2050.

From a market perspective, LNG is currently and will likely remain a key source of supply for the EU. Market players should have the full flexibility to define their own strategy to continue to ensure a competitive and reliable supply on market basis, while attempting to strike an appropriate balance taking into account the risk of extremely high prices in situations of market stress, as experienced during last year's crisis. For some companies, long term contracts are instrumental to secure investments and stable supply.

III. Lessons learned on the existing regulatory framework and the integration of the long-term framework of emergency measures

The EU regulatory regime for LNG is well established and has proved more than capable of delivering new infrastructure and sufficient quantities of regasification to meet demand in times of normal operation and in crisis. Indeed, the existing regulation is not an issue by itself – it enabled sourcing of LNG in 2022, albeit at very high prices due to the global scarcity.

The EU has proven willing to pay the price necessary to provide SoS but should not create regulatory barriers which prevent the true market value of gas/LNG being realised, such as the market correction mechanism.

Any sudden change to the regulatory regime or untoward intervention in wholesale gas markets e.g. market correction mechanism, risks damaging this capability and the EU's reputation for competitive and dynamic energy markets. It may therefore be premature to call for deep regulatory changes. It may however be beneficial to assess the functioning of the market and explore if/how improvements could be made to the regulatory framework.

IV. Functioning of the market: access model, Third Party Access (TPA), transparency, tariffs discounts and capacity allocation

1. Access model and the role of TPA in EU LNG terminals

Eurogas considers that that the TPA exemption regime remains broadly fit for purpose and that there is no need for substantial changes in the current regulatory framework. While the allocation of TPA exemptions needs to be carefully assessed taking into account the regional market context, these exemptions have not led to any negative effects on market functioning.

However, efforts should be undertaken to ensure that short-term TPA to terminal is available to new entrants and small shippers. In the broader context of exemptions, it should be noted that exempted terminals may have more autonomy to select their users and allocate primary/secondary capacity. In addition, operators of regulated terminals in some countries seem at times not incentivised to maximise the capacity that they make available and to optimise its use, as their allowed revenues,

[5] Energy Intelligence – Norway Reinforces Role As Stable, Long-Term Supplier (September 2022)
[6] Al Jazeera – Canada would need 'business case' for LNG exports to Europe: PM (August 2022)

which serve as a basis for tariff-setting, are not/only to a limited extent influenced by qualitative indicators, but are in general determined based on efficiently incurred operational expenditures and allowed capital remuneration.

In order to bring improvements, the following solutions could be explored:

- New exemptions:
  - It is understandable that new players would be keen to get new exemptions. In certain MS e.g. DE, (land based) terminals have been granted limited exemptions e.g. to provide 10% short term access. However, it is up to the national regulator to ensure that exemptions or regulated capacity allocation procedures do not foreclose the market, give undue advantage to certain market participants or restrict opportunities for spot trading. To this extent, regulatory guidance from ACER/CEER may be helpful for new infrastructures, always taking into account the specificities of every national market and regulatory context.
  - Review and adjust requirements/criteria for granting new exemptions to also include minimum transparency requirements regarding tariffs, capacity availability and contractual terms, as well as requirements regarding primary/secondary capacity allocation, and to properly take into account the exemption's impacts on inter-terminal competition at the supra-national level[7].
- Currently exempted terminals:
  - Take into account the importance that the exempted infrastructures have had for the system, as the exemptions were given on the basis of long terms contracts aimed at bringing gas to the European market enabling the development of new sources of gas supply. To preserve the rights and the economic assumptions of market operators, the execution of long terms agreements must always be ensured,
  - Taking into account norms and regulatory context, explore the legal feasibility to change, - during the exemption term - specific requirements that apply for exempted terminals, with the aims to enhance transparency (e.g. participation in centralised transparency platform) of capacity allocation practices, both for primary and secondary capacity[8],
  - Ensure that the regulatory regime eventually applied at the expiry of their terms, if not postponed, will allow them to compete equally and effectively within their regional markets, by imposing on them the same requirements as on currently regulated terminals.

2. Transparency

While terminals' transparency greatly improved notably due to the GLE transparency template and ALSI, Eurogas underlines the need for a more harmonised approach toward transparency.

Even though actual terminal users can easily obtain commercial information from LNG terminals (including from exempted terminals), it may be less accessible for prospective users/smaller LNG shippers who want to enter the LNG market, as potential users and who might have more difficulties in accessing the information they need on terminal terms of use, tariffs, and open capacity slots.

[7] Study on Gas market upgrading and modernisation – Regulatory framework for LNG terminals, Trinomics, REKK, Enquidity

[8] Ibid

Recently, the Article 13 of the Council Regulation EU (2022/2576)[9] introduced requirements for LNG facility operators and gas storage facilities operators to publish all information required in Article 19 of Regulation (EC) (715/2009) on a common European LNG Transparency Platform and a European Storage Transparency platform, with the possibility to NRAs for request more information, and the requirement for exempted LNG facilities/gas storage facilities under nTPA to make public final tariffs. Eurogas agrees with the ambitions of these measures and supports the reliance on common platforms. However, for exempted terminals it is worth considering that the exemption was granted in relation to long terms contracts, necessary to build the infrastructure.

REMIT Regulation also has a critical impact on increasing transparency and Eurogas remains available to provide views on specific issues.

3. Tariffs discounts

The Regulation (EU) 2022/1032[10] offers the possibility for national regulatory authority to apply until 31 December 2025 a 100% tariff discount to "*capacity-based transmission and distribution tariffs at entry points from, and exit points to, underground gas storage facilities and LNG facilities, unless and to the extent that such a facility which is connected to more than one transmission or distribution network is used to compete with an interconnection point*" **It should be noted that Member States already today can decide to apply 100% tariff discounts, via the existing Tariff Network Code.** Furthermore, Eurogas stresses that this exceptional measure was adopted in a context of crisis and welcomes the sunset date included in this measure a first step in the right direction to limit in time emergency measures. As for other emergency measures, Eurogas underlines the need for caution and to avoid automatic integration in the long-term framework.

The deployment of FSRUs however opens a new discussion regarding level playing field with land-based infrastructure. Depending on the national regulatory framework, FSRUs might not be exposed to the same long-term commitment and stranded asset's risks, which may require differentiated approach regarding entry tariffs to ensure a level playing field. It should be noted that the status of national discussions on this matter varies greatly, Eurogas and its members remain available to provide feedback ahead of any regulatory decision.

4. Capacity allocation

a. Market-based capacity allocation and harmonisation

All terminals use an open procedure (accessible to all market parties) to allocate primary capacity, but improvements in terms of market reflectiveness, market transparency and contractual flexibility could still be achieved. This would allow markets to respond to price signals in the most efficient way possible while preventing that the regasification costs stand in the way of more volumes.

Although all LNG regulated terminals are in principle relying on non-discriminatory mechanisms to allocate their primary capacity, some LSOs have in practice allocated all available capacity via long term contracts to a single terminal user which might negatively affect market liquidity and competition if it consists in a capacity hoarding practice.

[9] Council Regulation (EU) 2022/2576 of 19 December 2022 enhancing solidarity through better coordination of gas purchases, reliable price benchmarks and exchanges of gas across borders
[10] Regulation (EU) 2022/1032 of the European Parliament and of the Council of 29 June 2022 amending Regulations (EU) 2017/1938 and (EC) No 715/2009 with regard to gas storage

<u>In order to bring improvements, the following solutions could be explored[11]:</u>

- Ensure market-based primary capacity allocation in LNG terminals.
- Develop a minimum standard set of products that could be offered by all terminals, making it easy to compare/and contractual terms, thereby potentially increasing market liquidity and terminal usage.
- In selling capacity LSOs should consider appropriate margins to deal with contingencies (e.g. malfunctions, bad weather conditions); in particular, in case of impossibility to respect the defined regasification program, default rules could help in addressing users' uncertainty

b. Balance between short and long term

With increased imports and hence market offers, larger number of terminals, global competition, and willingness to answer to market signal, Eurogas underlines that while long term allocation remains crucial to get projects to FID/new LNG contracts to secure supply, giving access to short term products from the beginning of operations is essential for the market.

Beyond capacities booking, access to other services e.g. regasification on a shorter term basis must be ensured. **Concrete improvements could stem from the development of standardised products and the reservation of a minimum share of at least 10% of the total regasification capacity to shorter-term products**, without affecting existing long-term agreements.

c. UIOLI/UIOSI and trading on the secondary market

Eurogas recognises the importance to respect the right of primary capacity holders to try to use their capacity. Nevertheless, it is critical to ensure efficient allocation, maximise the potential use of LNG terminals and ensure necessary measures are in place to manage potential congestion in period of high demand. To that end, multiple mechanisms can be put in place, such as the ability to trade on the secondary market or the use of UIOLI/UIOSI mechanisms to address historically allocated slots not being used.

- Whereas almost all LNG terminals have rules in place to make unused primary capacity available to interested market parties, there is no common EU rule to require UIOLI/UIOSI at LNG terminals, and subsequently, there is a degree of discretion for NRAs regarding CAM, UIOLI/UIOSI procedures, and tariffs.
- For secondary capacity booking, the recent Council Regulation EU (2022/2576)[12] in its Article 12 introduced provisions to rely on a single platform for LNG facility users and gas storage facility users to re-sell their contracted capacity on the secondary market, which could overall facilitate secondary trading of capacities.

<u>In order to bring improvements, the following solutions could be explored:</u>

- Evaluate the opportunity to implement UIOLI/UIOSI-principles at all terminals, with a degree of standardisation e.g. lead times, allocation mechanisms, price methodology. To that end, in light of the measures introduced by Article 14 of the aforementioned Council Regulation, Eurogas underlines the need to properly assess that the measures explored are not ultimately counterproductive with regards to Security of Supply. The legitimate capacity under-utilisation behaviours dictated by market dynamics must be managed taking into

[11] Ibid
[12] Ibid

account the cost actually borne by the original users and their right to utilise their contractual flexibility.

- The phenomenon of capacity hoarding should be better analysed and opposed in order to ensure SoS, considering local market needs.
- Where not foreseen, develop mechanisms for regular calculation and allocation of regasification slots (sometimes referred to as "dynamic slot allocation") to ensure terminals' responsiveness to global market conditions, always taking into account the need to preserve existing contractual rights of current users.
- To make the reallocation procedure effective, to avoid opportunistic behaviour, an economic commitment linked to the transfer of the right of use should be provided. This would create a greater incentive to actually use the slot.