28 August 2006

GIE Response to Commission's Green Paper

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Ref. 06 GIE 204 – final

Executive Summary

Gas Infrastructure Europe (GIE) welcomes the opportunity to contribute to the Commission's Green Paper, "A European Strategy for Sustainable, Competitive and Secure Energy".

The Green paper identifies six priority areas, of particular importance to infrastructure operators are:

- Energy for growth and jobs in Europe: completing the internal European electricity and gas market
- An Internal Energy market that guarantees security of supply: solidarity between Member States

GIE considers that in fulfilment of the two priorities mentioned above particular attention should be paid to investment. Sufficient investment is necessary to enable cross border trade and to provide access for new market entrants, without investment the single European market will not be completed and consumers will not benefit from supplier choice.

Our main conclusions are:

- We believe that the key issue in completing the internal market and guaranteeing security of supply is investment.
- We have identified that the major impediment to investment is the regulatory / access regime. Infrastructure operators rate this issue as the most important for the viability of new investments, however it is the area of least satisfaction.
- GIE proposes and is committed to take forward an action plan to improve the investment climate for infrastructure operators in Europe, in consultation and in conjunction with the Commission, regulators and other relevant stakeholders.
- We are also committed to ensuring non-discriminatory and transparent access to infrastructure and strongly believe that the existing legislative and voluntary measures are sufficient to deliver this. What is now required is for Member States, regulators and infrastructure operators to fully implement the agreed measures without delay.
- To develop a fully functioning European Grid requires focus on specific goals which we believe can be delivered through existing organizations and measures.
- GIE would be happy to meet with the Commission and discuss further any of the elements of this paper and its proposals.

Gas Infrastructure Europe - GIE represents the interest of the infrastructure industry in the natural gas business such as Transmission System Operators ("TSOs"), Storage System Operators ("SSOs") and liquefied natural gas Terminal Operators ("LNG TOs"). GIE has currently 54 members in 28 European countries. GIE is based on three columns – GTE - Gas Transmission Europe, GSE - Gas Storage Europe and GLE - Gas LNG Europe.

1. Introduction

GIE has already published a preliminary response to the Green Paper on 14 June 2006, following a presentation by Geert Joosten, GIE President, at Madrid Forum XI. In addition the Association has actively participated in discussions with many stakeholders, including the Commission, on this very important topic.

GIE fully supports the Commission's desire to accelerate and complete market liberalisation in Europe, whilst ensuring security of supply.

The following short paper will focus on the Commission's proposals with regard to the completion of the internal European gas market and security of supply and then specifically on investment. The paper builds upon the Association's preliminary response, the fruitful discussions with stakeholders and incorporates the results of a detailed investment survey completed internally by infrastructure operators.

2. Comments on Commission Proposals

With regard to the concrete proposals of the Green Paper and how the first two priorities should be achieved we would like to re-iterate and add to the comments from our preliminary response:

European Grid
In developing a European Grid, we need to have a clear and shared understanding of what we are trying to achieve. The aim should be to create the conditions that allow gas to flow and be traded freely throughout Europe. This should be the measure by which all initiatives are prioritised and assessed. However we need to be careful that we do not unnecessarily pursue harmonisation as a goal in its own right and introduce avoidable costs. We should also recognise that gas is different to electricity. 60% of all gas transported flows across at least one national border, therefore a European Grid and the operational rules are already largely in place.

In considering the three proposed European Grid concepts (European Regulator, European Grid Code, European Centre for Energy Networks), GIE supports the following aspects:

- **increased regulatory co-operation for cross-border investments**. With the support of the Commission, we believe that this should be achievable through existing structures, such as ERGEG and the Regional Co-ordination Committees.

- **improved cross-border trading conditions**. The work of EASEE-Gas and the introduction of the Gas Regulation are having a positive impact in this area. We also look forward to further developments, with the Commission's inventory of interoperability and the finalisation of the Commission's explanatory notes on the Gas Regulation.

- **strong involvement and co-operation of infrastructure operators** - both in terms of new policy development and investment planning. The Gas Regulation already recognises the need to involve infrastructure operators in amending policy. However to move the consultation role for gas infrastructure operators on to a firmer footing would be most welcome. In terms of investment, as mentioned above we see that there is a clear need to improve the investment climate in Europe. Section 4 details our proposed action plan to deal with this issue, which will establish a key focal point for infrastructure operators to engage with the Commission and other stakeholders on future investment planning.

From our perspective the key to achieving a fully functioning European Grid is to focus on clear goals. Above we have outlined the fundamental issues, which with the continued commitment of all stakeholders could be largely addressed through existing structures. Therefore at this stage we do not think it would be beneficial to introduce new organisations, such as a European Regulator, which could introduce a further layer of bureaucracy.

Enhancing Security of Supply in the Internal Market

We believe that measures in the Security of Supply Directive 2004/67/EC provide sufficient basis to address Security of Supply (SOS). The Directive came into force on the 19 May 2006 and provides a good set of output based measures to protect supplies. In addition the remit of the Gas Co-ordination Group (GCG), with Member State support, is well suited to deal with the other issues raised in the Green Paper, for example monitoring demand and supply patterns and preparing for emergencies. We would be happy to further explore with the Commission the development of the GCG and in particular how this could fulfil the role of the proposed Information Observatory.

As European infrastructure operators, we have only limited involvement with upstream producing countries, however we do support the Commission's aim to improve relationships with these countries.

Emergency Gas Stocks

GIE considers that, in effect the implementation of emergency gas stocks for Europe may be an extremely expensive possibility and not a necessary one, taking into account the benefits accruing from alternative measures that tend to favour the protection of consumers via the creation of a well connected and integrated market and diversity of supply sources (both from a geographical and a technological point of view).

GIE believes further work is needed and that the following issues would need to be well considered before any further decision on emergency gas stocks provisions could be taken.

1. The putting in place of so called emergency gas stocks could create a risk of undermining the incentive for commercial investment in storage, if these were also to be used as a tool to accommodate market flexibility needs.

2. The volume destined to emergency stocks would be "captive" until an emergency occurs and will be withdrawn from (and thereby putting additional strain on) the market, whereas the storage capacities are useful for market modulation either in existing or in new storages.

3. Before creating emergency gas stocks it should be assessed the possible repercussions on present and future gas prices for final consumers and thereby on the competitiveness of natural gas.

3. Investment

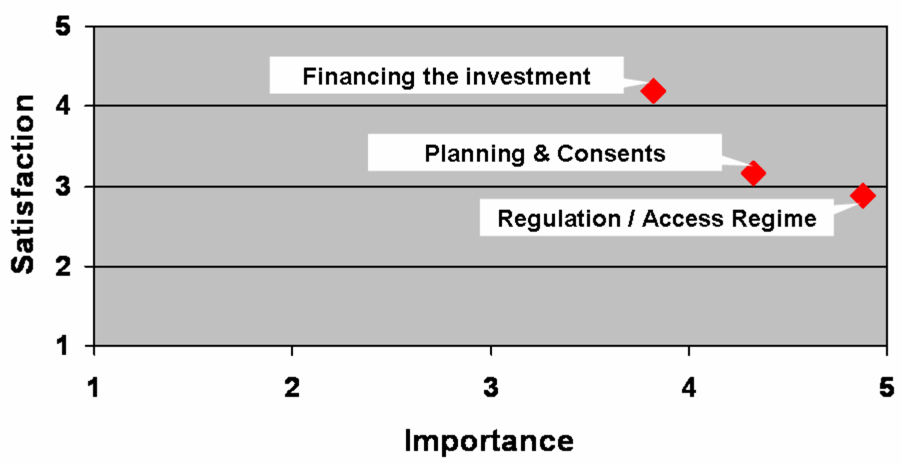
We are encouraged by the Commission's acknowledgement in the Green Paper of the urgent need for investment. From our perspective this should be the key priority for the Commission, Member States and Regulators, if we genuinely want to create a single European market. It should be recognised that without sufficient investment market liberalization and the benefits of consumer choice will not be delivered.

To address this issue, we believe the questions that must be answered are; what are the barriers to investment? And how could these be removed? In order to provide input to the Commission on these questions, GIE has conducted an extensive survey of our Members. The survey focussed on three main areas; Planning & Consents, Financing the Investment and the Regulation / Access Regime.

Although there are variances across the EU and infrastructure types, the high level results from the survey are:

- In terms of importance for the viability of new investments, Regulation / Access Regime was rated very important followed by Planning and Consents and Financing, which were both rated important (see Figure 1).

Figure 1: Importance and Satisfaction ratings for different aspects of investments



- With regard to satisfaction, the highest levels of satisfaction were associated with financing and the lowest with Regulation / Access Regime (See Figure 1). Across the infrastructure types the greatest level of satisfaction with Regulation / Access Regime was experienced by storage facilities, several of which are exempt from regulated access and prices.

Based on the above analysis and the comments received, **a key conclusion from the survey is that Planning & Consents and to a lesser extent Financing are issues that delay and complicate the investment, however the regulatory framework can prevent the investment.**

Regulatory Framework
As identified above the most important aspect in relation to the viability of new investments is the regulatory framework and at present there is a low level of satisfaction in relation to this topic for all infrastructure types. Below is a few quotations that illustrate the dissatisfaction felt by infrastructure operators:

> *"Uncertainty about treatment of investments in current and future regulatory regimes (regulatory risk), including ex post approval of investments"*
> *"The Regulator changes the remuneration rules (rate of return,…) after the investment is decided."*
> *"Complexity of UIOLI mechanism for LNG terminals and apparent preference of regulators for arrangements which are unattractive to customers (LNG shippers)"*
> *"Uncertainty regarding introduction of price regulation"* [Storage]

As infrastructure operators we have been calling for sometime for an investment climate which is:

- predictable;
- stable;
- commensurate (allowing an appropriate remuneration taking into account the risks involved) and complete.

From the statements made above it is apparent that this investment climate has not been achieved. As part of the survey, our Members put forward solutions to these Regulatory / Access Regime issues, a few examples are as follows:

> *"The directive allows for a special regulatory regime under art 22. It would be beneficial if regulators and relevant authorities subscribed more explicitly to the mechanisms of establishing a regulatory regime under article 22, rather than aim at avoiding as much as possible the use of this instrument."*
> *"Set up a tariff for a 3 to 5 years regulation period."*
> *"Allow the TSO to take a long term view of transmission investment, rather than piecemeal, with appropriate recompense, this is particularly important for [LNG] terminals that are developed in phases."*
> *"Clear statement for non-regulated access to storage facilities"*

Generally the above points are consistent with the requirements stated above for a conducive investment climate. These are relatively simple and high level goals to be achieved, which should be supported by all stakeholders, however they are still not in place even after 8 years since the publication of the first Internal Gas Market directive. As infrastructure operators we see a pre-occupation in the European gas market with developing new access rules and guidelines, we do not see the same level of attention applied to ensuring that the conditions are in place, both nationally and at European level, to bring forward essential investments.

With regard to the topic of new rules and guidelines for access to infrastructure, the key issue for users of infrastructure is ensuring transparent and non-discriminatory access, whilst at the same time protecting commercial information. From our perspective, the existing European legislation and other policy measures are sufficient to deliver this objective. This is borne out by the emergence of competitive markets in a number of countries. However, we recognise that progress has been slower than anticipated and that in some countries the benefits of competition have yet to be felt. To address the situation it is necessary for Member States, regulators and infrastructure operators to fully implement the agreed measures without delay.

Non-domestic Investments

Non-domestic investment[1] presents additional challenges as it often involves making an investment in one country that benefits another. Previously integrated companies were able to bring forward such investments through long term capacity and supply contracts. In a liberalised market these investments are more difficult to identify and fund. Currently at a European level there is a lack of transparency with regard to future investment needs. As investments take at least 5 years to realize, this lack of transparency leads to inefficient and non-timely investment. From the investment survey and stakeholder discussions, the following specific issues have been raised:

- With a move to short term contracts with end users and competition, very few gas suppliers are able or willing to take a long term view and signal their investment needs. This leads to a lack of investment and investment being made in a non-timely fashion.
- Without investment signals and long term binding commitments, TSOs are unable to make investments as the risk profile is not commensurate with the generally allowed rates of return.
- Even with sufficient signals and associated long term binding commitments, TSOs usually only build to the signal. Therefore no capacity is available for short term trading, limiting the scope for competition. In addition TSOs systems become tighter at a time when predictability of flows is decreasing, particularly with the emergence of traded market and LNG terminals.
- National regulators generally only have an obligation to protect their own end users, therefore in some cases this may prevent projects of European interest progressing.
- There is a lack of co-ordination between regulators and infrastructure operators in adjacent countries with regard to investment planning and capacity allocation, therefore the European Grid is developing inconsistently and inefficiently.

4. Proposed Investment Action Plan

GIE is committed, in conjunction with the Commission and other relevant stakeholders, to improving the investment climate for infrastructure operators in Europe. To support this, GIE proposes:

1. To establish a new work group within GIE specifically dedicated to infrastructure investment. This group will be chaired by a senior gas infrastructure executive, who will act as the focal point for all GIE discussions with stakeholders on this crucial topic. Key objectives and tasks of this work group will be:

   - To drive forward at a European level, where appropriate the co-ordination between infrastructure operators on future investments
   - To champion the removal of investment barriers throughout the EU
   - To identify differences in the legal frameworks and regulatory regimes, which impede investment in cross-border infrastructure
   - To develop and propose solutions for the removal of the identified impediments

[1] In the electricity industry the term cross-border investment is commonly used to describe interconnections between two grids. However, we do not think that this term alone is suitable for the gas industry, where the investment may involve infrastructure transporting large volumes of gas over long distances and spanning several countries. We therefore prefer to use the term non-domestic investment.

- To identify, share and publicise best regulatory practice in creating a conductive investment environment, including the promotion of effective cooperation among regulators and with infrastructure operators for cross-border projects
- To work with the Commission on the Priority Interconnection Plan

2. To prepare a workshop on investment in October where further results from GIE's investment survey will be presented to the Commission, regulators and other relevant stakeholders, who will be invited to respond and input into these discussions.

3. To bring forward the issue of investment in all of the energy markets of the ERGEG Gas Regional Initiative, in order that the real practical issues of investments may be considered and addressed.