



**European Commission's Proposal for a
Regulation of the European Parliament
and of the Council concerning
measures to safeguard security of gas
supply and repealing Directive
2004/67/EC (COM (2009)363)**

EREGG comments

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Introduction

Following the dispute between Ukraine and Russia, which led to a disruption of gas supplies to Europe, the European Commission undertook to bring forward its review of the Security of Supply Directive¹. The disruption of Russian gas supplies transiting Ukraine in January 2009 has indeed exacerbated EU concern for the security of supply which had already been emphasized by the European Commission in November 2008 in its 2nd Strategic Energy Review². The crisis has demonstrated some necessary improvements in terms of infrastructure availability and supply diversification which were pointed out by ERGEG in its letter to Commissioner Piebalgs³. Improving security of supply therefore calls for additional efforts to develop a fully competitive internal gas market in Europe in order to generate the right investment signals and provide effective fair and non-discriminatory network access to all parties. All conditions have to be met to ensure that market mechanisms continue even under strained gas supply conditions, with government intervention as a last resort.

Several lessons can be drawn from the crisis. Firstly, it is necessary to improve the level of preparedness as well as the response capacity of the EU gas system to major gas supply disruptions at international level. The second lesson is that the consequences were not always fully understandable and predictable due to the profound lack of transparency of gas flows and emergency arrangements within the European Union and beyond. The crisis also showed the market's capability to provide some flexibility, which confirms how important building the single market is for developing reliable gas supplies.

Security of supply has been a priority for European energy regulators who have established a specific task force dedicated to the security of supply. The ERGEG South-South-East Gas Region demonstrated how useful the Gas Regional Initiative can be with regard to the coordination of stakeholders at regional level in the case of crisis. Moreover ERGEG has contributed to feeding the debates on the EU 10-year network development plan which shall consider security of supply as a key dimension.

There is a broad consensus on the positive effect market integration in Europe will have on the security of supply. Moreover, investment is considered a key tool to improve the EU gas system's capacity to mitigate gas supply risks. Regulators play an important role in these areas.

EREGG therefore considers that regulators should be included in the debate on security of gas supplies. While inviting ERGEG to the Gas Coordination Group is a first important step in this direction, a permanent involvement of all individual NRAs should still be considered.

EREGG welcomes the European Commission's approach to security of supply and below presents a number of comments and proposals regarding the Proposal for a Regulation concerning measures to safeguard security of gas supply and repealing Directive 2004/67/EC (further only "Proposal for a Regulation") of 16 July 2009.

¹ Directive 2004/67/EC of 26 April 2004 concerning measures to safeguard security of natural gas supply

² Second Strategic Energy Review: an EU energy security and solidarity action plan, 13 November 2008

³ ERGEG Letter to Commissioner Piebalgs advising on lessons from Russia-Ukraine gas dispute, 10 February 2009

1. Background principles

1.1 ERGEG approach to security of gas supply

ERGEG sees three interdependent dimensions to security of supply: a political one, a technical one and an economic one. The political dimension relates to the sensitivity of society to a disruption of supply and the efforts it is ready to make to mitigate the risk. The technical dimension relates to the means and measures which can be implemented to reach the political goals. The economic dimension relates to general efficiency criteria that need to be considered in the decision between possible options. ERGEG also sees two kinds of risks: endogenous risks, i.e. risks relating to the internal organisation/structure of the EU gas system, and exogenous risks, i.e. risks relating to factors external to the EU, like geopolitical issues or non-EU parts of the gas chain. This means that securing gas supplies requires both secured access to gas resources and a high degree of reliability and flexibility of the European gas system. As a result, security of supply is a task to be addressed comprehensively by measures concerning both the Internal Energy Market and EU external energy policy.

European energy regulators consider that they should not have to comment on the political issues falling within the competency of governments and the European Commission. They state, however, that technical issues, in particular the present Proposal for a Regulation on security of supply have a direct impact on their areas of competency, including the development of competitive and effective markets as well as the regulation of networks. As a consequence, regulators have a legitimate interest to comment on technical measures and their economic dimension in respect of the regulators' area of competency, and to contribute to the evaluation of the trade-off between the proposed measures and the risks they are supposed to mitigate. Regulators reiterate on the need to look for the most efficient options, i.e. providing the best balance between costs and security for consumers. For instance, investments in security of supply should be carefully evaluated in order to determine their costs/benefits to consumers and to establish whether they create market distortions, in particular by displacing the development of market based investment, including private import projects (LNG terminals) or interconnection.

1.2 General ERGEG views on the Proposal for a Regulation

The Proposal for a Regulation presents several proposals regarding institutions and procedures. The designation of a Competent Authority responsible for the security of gas supply at national level is an important step towards more transparency and efficiency. ERGEG notably appreciates that regulators are considered an important part of the processes, particularly as far as efficiency and investment are concerned.

The Proposal for a Regulation includes **three different areas of analysis**. It first develops an approach to security of supply based on either **prevention or response**, translated into two types of action plans. The second area is **evaluation**, namely the assessment of the actual vulnerability to supply risks and the need for their mitigation. The third area relates to the **implementation of concrete measures**. ERGEG welcomes this approach which clearly establishes an EU security of supply strategy.

On the basis of its approach to security of gas supply, ERGEG presents the following comments on the Proposal for a Regulation:

- ERGEG considers the Commission's proposal to be a **valuable approach for the coordination of infrastructure planning, investment and operational processes at regional level.**
- It has to be ensured that **NRAs are involved, to a high degree, in the implementation of the Regulation** as far as it concerns areas for which the regulators are responsible.
- The **envisaged planning instruments shall be used in the best possible way to bring into line the aims of improving** the security of supply and the functioning of the internal gas market.
- **Infrastructure and supply standards have to be carefully considered** since the Member States' position in respect of security of supply is very different. For example, some are more diverse than others in their sources of supply. Therefore there is scope for the rules to be applied differently.
- The **costs of security of supply, especially those emerging from infrastructure development** and supply standard provisions, **should be allocated in a balanced way** between the countries concerned.
- **Risk assessment should be considered as the basis of the EU's approach** to security of supply. ERGEG suggests that any measure should be based on a sound estimation of risks, including the likeliness of supply disruption and the foreseeable impact on the gas system at national and Community levels.
- In this context, the **adequacy of infrastructure and supply standards should be evaluated on the basis of risk assessment** in order to avoid unnecessary investments or overly expensive measures. In the end, risk assessment could demonstrate that exemptions from N-1 and reverse flow standards are justified and therefore should not be implemented rigidly.
- **Transparency** is essential and must be a priority. The Ukraine/Russia crisis highlighted the importance of transparency of storage levels (including injection and withdrawal rates) and of gas flows. It is also essential that obligations to meet security of supply are published.
- It is also **important to be careful with the timeframe for the discussion and implementation of the measures** contained in the proposal, considering the challenges they imply for the Member States.

2. Detailed ERGEG comments on the Proposal for a Regulation

2.1 Beneficiaries of the Regulation: "Protected Customers" (Art. 2)

The aim of the Proposal for a Regulation is to ensure security of supply, primarily for the benefit of "protected customers". Protected customers are defined as *"all household customers already connected to a gas distribution network and, if the Member State concerned so decides, also small and medium-sized enterprises, schools and hospitals, provided that they are already connected to a gas distribution network"*. ERGEG proposes allowing Member States to extend the category of "protected customers" to gas fired power plants where this is justified by the national electricity generation structure.

Apart from that, the Proposal for a Regulation itself contains some incoherence with regard to the scope of protection granted by the proposed measures. While the obligations associated with the supply standard (Art. 7) explicitly focus on “protected customers”, the fulfilment of the N-1 infrastructure standard (Art. 6), for instance, relates to “total gas demand of the calculated area”. ERGEG recommends clarifying the scope of these obligations.

2.2 Responsibility for security of supply and competence of NRAs (Art. 2)

The Proposal for a Regulation requires Member States to designate a “Competent Authority” (the NRA or national governmental authority) responsible for the implementation of security of supply measures. This new authority will play a pivotal role of coordination and evaluation, while some specific tasks under the Proposal for a Regulation might be delegated to other authorities.

EREGG considers the envisaged involvement of NRAs (where they are not designated as the competent authority) and the Agency to be an important step forward. The Proposal for a Regulation requires that NRAs be consulted when the Preventive Action Plan (**PAP**) and the Emergency Plan (**EP**) are established (Art. 4 (1); NRAs and the Competent Authority shall **cooperate** in the **risk assessment** (Art. 8 (2)). The Agency is consulted by the Commission during the preparation of the two plans, to recommend at which regional level these plans should be set up if necessary (Art. 4 (3), and before final approval (Art. 4 (6)).

In order to ensure an appropriate involvement of NRAs in security of supply issues, ERGEG proposes to formally grant them an institutional role, in particular regarding network related questions (e.g. implementation of N-1 or reverse flow requirements in the PAP). ERGEG recommends that **participation** in the **Gas Coordination Group** be **extended to NRAs** (Art. 11, par. 1). ERGEG also stresses that **the NRAs' role** must **not be restricted** to mere **consultation** during the preparation of plans, especially the PAP, notably **to ensure consistency** between security of supply **measures** and network regulation within the **competence of NRAs**.

2.3 Preventive and Emergency Plans (Art. 4, 5 and 9)

One of the aims of the Proposal for a Regulation is to improve the capability of the EU gas system to cope with supply disruptions. Two aspects have been developed: prevention (Preventive Action Plans) and response (Emergency Plans and Community Emergency).

- **Preventive Action Plans** aim at mitigating the “risks identified”. These plans are to reduce the risk exposure of the gas system, i.e. to develop the capacity of infrastructures to cope with supply disruptions so that they comply with the infrastructure and supply standards (Art. 6 and 7).
- **Emergency Plans** concern mechanisms implemented in the case of crisis according to three crisis levels. These plans define procedures to be followed in the case of crisis.
- **In a Community Emergency**, the Commission takes the lead on action plans if two Member states or more are concerned by a supply disruption.

Preventive Action Plans and Emergency Plans lie within the responsibility of the Competent Authority, i.e. at national level. The role of the Commission is to verify the consistency of the national plans and to ensure coordination in case of a Community Emergency.

a) Links between the Preventive Action Plans and the Emergency Plans

The status and the links between the plans need to be described more precisely. The objective of the Preventive Action Plans is to reduce the system's vulnerability to the risk of supply disruption. This will translate into improvements which will change the nature of risks and the way the system responds. As a result, the implementation of Preventive Action Plans will have an impact on the need to implement the Emergency Plans. Therefore, Preventive and Emergency plans should be updated regularly. This dynamic dimension of security of supply is addressed in the provisions on risk assessment; but should be addressed in Articles 4, 5 and 9 as well.

b) Preventive Action Plans

EREGG agrees with the Proposal's methodology as regards preparation of the PAP. However, the concept of risk is fundamental in establishing the PAP. This is not sufficiently taken into account in the Proposal for a Regulation. In fact, two kinds of risks are to be distinguished, endogenous and exogenous ones, which should be described either in Art. 5 or in Art. 8 (see below pt. 2.5). The PAP focuses mostly on reducing endogenous risks directly by establishing security standards, investing in or improving the use of infrastructure, etc. There are still exogenous risks, of which the dispute between Russia and Ukraine gives a clear example. It is not possible to influence these risks directly; the aim of the Proposal for a Regulation should therefore be to ensure that the internal market can effectively respond to external risks.

Art. 5 (3) states that the PAP shall take the **economic effectiveness** into account. It would be useful if this term was explained. In the EREGG's view, the main principle is that **market based measures** should be allowed to work **as long as possible**. The meaning of the term "market based measures" should be made explicit in the Proposal for a Regulation. Non-market based measures should only be introduced when the market fails to ensure sufficient supply.

EREGG identifies two elements: First, **the most efficient solution has to be selected** where several options are available. Second, the results of **risk assessment** should **inform** the scope of measures under Art 5 (1) lit a), i.e. whether any **exemptions from infrastructure and supply standards** are justified if there is evidence of a low level of risk.

c) Emergency Plans

The main EREGG comment on this issue is that the **market should be allowed to function as long as possible** but that, in case an emergency is declared, the roles and responsibilities of all relevant parties should be clear. However, the prescribed procedures should not be too detailed, in order to keep some flexibility. In EREGG's view, detailed procedures are required for the "emergency" level only. Procedures implemented in the "early warning" and "alert" levels (in which the market is able to resolve the situation without the Competent Authority's intervention) should consist in preparing a possible transition to the "emergency" level and in mitigating the impact of disruption. **The crisis levels should therefore be addressed as consecutive steps towards an acute crisis requiring public intervention.**

d) Community Emergency (Art. 10)

EREGG welcomes the possibility of declaring a "Community Emergency" provided by the Proposal for a Regulation as an **option of last resort** to **coordinate Community wide actions**. It is also appreciated that the Proposal for a Regulation foresees the option of declaring a **limited Community Emergency** which affects only a **specific region** of the Community.

With regard to the trigger for declaring a Community Emergency, ERGEG however considers that the Proposal for a Regulation should set a **significantly higher threshold** for the Commission (in particular as far as “at request of one Competent Authority” is concerned, see Art. 10 (1)). ERGEG would like to emphasize that in principle, risk management **on a national or regional level** sufficiently **guarantees a higher degree of effectiveness** of the measures to cope with risks. If decision making processes are carried out on a regional level, it takes often less time to **respond properly** to changing situations. In addition, it can be assumed that the Competent Authority or other national authorities are generally **better prepared** in terms of conducting **effective risk management** since they often have **proper knowledge** and a **better understanding** of the **specific circumstances**. In this regard, ERGEG recommends to build upon the experience acquired through the Gas Regional Initiatives.

2.4 Security standards

a) N-1 Standard (Art. 6 (1)-(4))

The main principle of the N-1 indicator is that in the event of failure of the largest gas supply infrastructure and/or supply source of a Member State (entry point, production field, LNG terminal, storage, etc.), **sufficient** capacity should exist in the remaining gas infrastructure to meet demand (at least for domestic consumption). The standard may also be met at regional level. An **exception** to fulfilling the N-1 standard is possible if the Member State can demonstrate (in the PAP) its capability to compensate a supply disruption solely by **demand-side measures**.

ERGEG understands that a common infrastructure standard is useful to guarantee the investments necessary for the well-functioning of the internal gas market in case of a supply disruption. ERGEG underlines however that the **application of the N-1 principle alone is not sufficient to improve security of supply**. The principle indeed covers the transmission route risk, but **neglects the sourcing risk**. Fulfilment of N-1 does not necessarily mean that gas will be available in times of a supply crisis (at a reasonable price). The sourcing dimension therefore needs to be addressed as well. In this regard, **supply diversification** is an **important tool** that helps to mitigate the exogenous risk of gas availability. A certain degree of **supply diversification should be compulsory** in Member States, if possible. ERGEG therefore suggests amending the Proposal for a Regulation with an additional Article regarding supply diversification with the same level of detail as the Article on the N-1 standard.

In the Proposal for a Regulation supply diversification is addressed by saying Member States have to co-operate in their regulation and incentives to encourage cross-border investment. It may also be useful to include a requirement for Member States/NRAs to co-operate on any proposals for cross-border inter-connectors in order to avoid a mismatch between entry/exit capacity under the N-1 rule.

ERGEG emphasises that the N-1 rule might have very strong effects and might lead to a **high financial burden** for those Member States which depend on a single gas supplier and/or one main import pipeline. This is especially true for Member States in Eastern Europe such as Poland, Slovakia or Lithuania. Apart from that, the rule could also have severe effects for other Member States. Compliance with the N-1 standard is easier for Member States with sufficiently **diversified supply routes** for gas imports. Any such rule would, realistically, have to **take account of the differences** in national **gas network configurations**, which can be very significant in some cases.

To overcome these difficulties, it should be clearly stated that risk assessment (Art. 8) is the first step on the basis of which **exemptions from the N-1 rule** may be granted. Risk assessment indeed allows to determine **specific infrastructure standards** for each **Member State** through a **simulation** of the network, according to the definition of relevant peak demand estimates.

EREGG is concerned about the proposed time **scale of three years** for the implementation of the N-1 rule. This period may **not be sufficient** for some countries.

Furthermore, the standard refers to a **period of 60 days** of gas to be supplied by the remaining infrastructures in the event of disruption of the largest infrastructure. The **rationale of this reference is not clear** as the formula itself contains a pure capacity/infrastructure standard. EREGG proposes that any standard should be based on a full analysis of the EU's exposure to risk and that some **clarification on the formula** (and how it applies) should be provided by the Regulation.

b) Bi-directional flow capacity (Art. 6 (5))

The Proposal for a Regulation requires TSOs to enable **permanent bi-directional flow capacity on all interconnections** within two years from its entry into force. It also provides for an **exemption** from this requirement if the addition of a bi-directional flow capacity **would not enhance** the security of supply of **any** Member State.

EREGG generally **welcomes** this proposal since the establishment of bi-directional flow capacity on interconnections can be an adequate instrument to safeguard security of gas supply and to enhance market integration at European level. Nevertheless, the **unspecific and general requirement** with respect to **all** interconnections **may be disproportionate**, notably if it involves significant investments. This applies in particular since, in some situations, it will not improve the security of supply of any Member State. EREGG acknowledges that removing obstacles to bi-directional flows would be a positive step towards more integration. One should nevertheless be aware that gas quality can represent an important constraint, especially as far as odourisation is concerned; this reflects different appreciations of technical security among Member States.

In any case, in order to meet the target of bi-directionality, the competences of **the Competent Authority need to be defined** and the **Authority must be provided with sufficient powers to apply** the Regulation. Since Art 6 (5) imposes the obligation to enable bi-directionality directly upon the TSOs, EREGG proposes that it should **be stipulated if, and in what respect**, the Competent Authority is **authorized** to take action against TSOs who fail to comply with their obligation to enable bi-directional flow capacity on certain interconnectors.

c) Financing of Infrastructure Standard (Art. 6 (7))

According to Art.6 (7), the implementation of the N-1 standard and permanent bi-directionality shall be **taken into account** by the NRAs in their **approval of tariffs**. It should be recognized that this may only be necessary where market demand does not justify building additional infrastructure. Besides, the Proposal for a Regulation requires that where infrastructure related costs are incurred in **more than one Member State**, the NRAs of all Member States concerned shall jointly decide on cost allocation.

EREGG is concerned that Art. 6 (7) is **not sufficiently detailed to ensure** a fair distribution among the Member States:

1. NRAs should be asked to consider only **efficient costs** relating to investments for security of supply purposes in their approval of tariffs.

2. By referring to Article 8 (1) Regulation (EC) No. 713/2009, the Proposal for a Regulation provides an inadequate **procedural concept** for Member States to agree on cost allocation. As cost allocation is always a crucial issue, the **procedure for reaching such joint decisions** has to be **specified**. Otherwise, the Proposal for a Regulation **might not be executable**.
3. The current wording of Art. 6 (7) only covers the case of costs for network expansion “incurred in more than one Member State”. The Proposal for a Regulation offers **no procedure for cost allocation** in the case of infrastructure investments **being made** in **one** Member State **only** but ensuring the security of supply of **another** Member State.

In general, a practical problem would **not occur** if these pipelines/capacities **were booked by shippers**. The costs of the investment **would be covered by the users of the infrastructure**, i.e. shippers. However, a problem arises if there is no specific / actual demand from shippers for the capacities (e.g. newly built bi-directional capacity against the usual gas flow East-West). In this case, the costs of the investment **may have to be borne by the TSOs** and, as part of the regulated asset base, **be passed through to the national end customers**. Therefore, Member States will have to consider the costs and benefits of such investments carefully. They will also need to consider the appropriate level of cost pass through to customers and whether a part of the costs should be borne by either the Member State, shippers or TSOs.

d) Supply standard (Art. 7)

The Proposal for a Regulation would require Member States to take measures to ensure that a certain **amount of gas is permanently available** in order to supply protected customers. As stipulated in Art. 7 (1), the amount of gas has to last in the case of

- a) extremely cold temperatures during a seven day peak period statistically occurring once every twenty years; and
- b) any period of sixty days of exceptionally high gas demand during the coldest period statistically occurring every twenty years.

The Proposal for a Regulation is not clear enough since it includes neither a definition of the conditions of “**extremely cold temperatures**” nor of the term “**exceptionally high gas demand**”. Without a clear definition it is hardly possible to determine the precise degree of “extremely cold temperatures”, especially because it is unclear which geographical location should be the relevant reference point for measuring the “extremely cold temperatures”.

With regard to the term “exceptionally high gas demand”, it is similarly difficult to identify the accurate demand rate, given the lack of a geographical reference point and of a definition of “exceptionally high”. It is therefore **hardly possible** for the Member States’ authorities **to determine** what quantity of gas is actually required to comply with the gas supply provisions. If the definition of the accurate quantity of gas in such critical situations is to be left to the discretion of Member States, it would be necessary to provide a more precise definition in the Proposal for a Regulation.

2.5 Risk Assessment (Art. 8)

EREGG recognises that there are some advantages associated with the fact that the Proposal for a Regulation does not prescribe detailed measures for ensuring compliance with the supply standard, but rather grants Member States discretion to measures to be taken. On the other hand, ERGEG is concerned that the Commission could use its reserved right to take final decisions under Art. 4 (6), by requiring a particular measure (such as strategic gas storages) to meet the supply standard. ERGEG **requests confirmation that measures** for ensuring compliance with the supply standard **are for Member States to decide**.

Risk assessment is key to defining the proper response and to determining the means to be dedicated to securing supplies. Risks are directly linked to security standards and the knowledge have about the consequences of supply disruptions. Risk assessment will be an important input to prevention and emergency plans. Risks of different nature should also be considered; ERGEG proposes to **distinguish** between **endogenous and exogenous risks** in this context.

The methodology of risk assessment should be further developed in order to ensure consistent estimations among Member States. ERGEG recommends that risk assessment **should be given much attention in order to ensure that** the provisions of the new Regulation will **not lead to the development of infrastructure above rational and economically sound levels**. In other words, risk assessment should combine probabilities of interruption of supplies, the impact on the functioning of the gas system (evaluation of system's resilience) and the economic and social internal and external costs of disruption.

Concerning simulations, ERGEG agrees with the usefulness of scenarios. However, the results shall be used carefully for the following reasons:

- scenario development is a difficult task and is, in any case, based on a simplification of reality;
- some crisis situations may not be identified, while being probable;
- the market's capability to cope with some crisis situations may be underestimated;
- without associated probabilities and costs, scenarios cannot be used for defining prevention measures.

The disruption of Russian supplies to Ukraine in January 2009 showed that experience is a key factor of risk assessment. The awareness of a risk is indeed highly dependent on the occurrence of the event in question. Before the crisis, such a disruption was considered possible, but nobody believed it would happen.

EREGG recommends that the amount of **investments which are promoted for security of supply purposes**, but not **requested by the market does not exceed the social cost of disruption weighted by the probability of the event** within the framework of the security standards.

2.6 Transparency

The Russia/Ukraine crisis demonstrated that transparency and access to up to date information are necessary to understand an emergency situation and to take appropriate decisions. ERGEG considers that further transparency requirements should be defined in the Proposal for a Regulation, particularly with regard to storage levels, gas flows and measures to be taken by Member States to meet the security standard. **Transparency is essential** to a resilient market and **enables a proper degree of cross-border coordination** which is needed for a market response to a gas supply disruption.