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Ensuring success for the EU Regulation on gas supply security

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We welcome the European Commission's proposal for a Regulation on the security of gas supply which, it is hoped, will be agreed at the Energy Council in May. The Regulation aims to help member states improve their gas security policies as ECFR argued the EU should do in a Policy Brief published before the gas crisis of January 2009¹. However, there remain some problems with the proposed Regulation, in particular the mechanism through which member states will be required to devise and implement gas security policies. This note aims to outline how these problems can be resolved.

Summary

1. The Commission's proposal for a Regulation on the security of gas supply has the right ambition for Europe. However, it is at risk of being substantially weakened in the ongoing Council negotiation. To make it a European policy success it should be clarified and simplified. The bottom-up dimension should be strengthened so that the text is less politically contentious for member states and more effective at raising the ambition of national gas supply security policies.

¹ See Pierre Noël, *Beyond Dependence: How to deal with Russian Gas* (ECFR/09, November 2008), available at http://ecfr.eu/content/entry/russia_gas_policy_brief/

2. The mechanism that will ensure that all member states devise and implement adequate gas security policies should be clarified. Of the two approaches present in the Regulation, a clear choice should be made in favour of a policy process based on national security assessments and national action plans. One or several supply standards could be given as indicative tools to be used in the assessments, not binding rules to be complied with. It would remove the incentive for member states to weaken the security of supply standards and with them the whole Regulation.
3. The policy process should be based on mandatory gas security assessments, performed in the context of regional gas security groups, leading to national action plans reviewed by the Commission and independent experts and made publicly available on the Internet. Such a process would serve the following purposes: (1) Reveal the gas security situation in all member states; (2) Increase and share knowledge among member states about gas security policies and measures, including their cost; (3) Incentivise national governments to make gas security policy choices that are economically sensible and politically responsible.
4. Finally, we suggest a few simple dispositions that would allow removal of the category of “protected” customers and the disagreements over its definition; as well as the very complex, politically contentious and potentially impractical architecture involving different categories of emergency situations, measures to address them and levels of responsibility.

I. Putting the national gas security assessments first

5. The objective of this Regulation is clear: that all member states address gas security seriously so that, when the next supply crisis hits, no country within the Union is at risk of significant economic losses, or worse. In the Commission’s proposal there are two largely conflicting approaches to achieving this²:
 - a. The first one consists of defining security of supply “standards” that, once applied by all member states, would guarantee a minimum level of security of supply across the EU. The most discussed of these rules is the “N-1” indicator.
 - b. The second approach consists of asking member states to perform “risk assessments” of their gas systems, based in part on the supply standards they have to comply with. Those assessments would be part of “preventive action plans” that the Commission would then review.

² See P Noel and S Findlater, “A comment on the draft EU Regulation on security of gas supply”, EPRG, University of Cambridge, 3 July 2009, available at: [http://www.eprg.group.cam.ac.uk/wpcontent/uploads/PN_SF_Comment%20on%20the%20draft%20Regulation\(2\).pdf](http://www.eprg.group.cam.ac.uk/wpcontent/uploads/PN_SF_Comment%20on%20the%20draft%20Regulation(2).pdf)

6. How those two approaches would interact in practice was, and still is, unclear. Requiring member states to perform risk assessments while at the same time asking them to comply with security of supply standards seems illogical:
 - a. The purpose of mandating gas security assessments is to *reveal* what degree of security a country enjoys and *discover* the cost of buying more insurance. On the basis of such an assessment the government can decide on a *sensible minimum level of supply security* for the country, and how to achieve it.
 - b. On the contrary, devising a set of “standards” that all member states should comply with amounts to mandating a uniform minimum level of security; it makes national security assessments redundant.
7. To make the Regulation simpler, more coherent and easier to negotiate on at the Council a clear choice should be made between these two approaches: top-down (standards) or bottom-up (security assessments). The negotiation at the Council so far has shown three clear trends:
 - a. The determination of the member states to weaken the standards. Arguably, we are already not far from a version where everybody complies with the standards *ex ante*.
 - b. The recognition that the risk assessment process and the national action plans are amongst the most valuable features of the Regulation.
 - c. The recognition that there should be more regional co-operation on gas security policy³.
8. The first of these three trends illustrates what the negotiation over the Directive 2004/67 had already shown, namely: that the standards approach, however appealing at first glance, faces serious hurdles in an EU negotiation. Mandating an arbitrary minimum level of security contradicts the member states’ legitimate claim to define *how much* insurance they should buy and *how* and *when* to buy it. (See section II of this memo.)
9. On this background, the second and third trends create an opportunity to make a clear choice in favour of a bottom-up approach based on security assessments, national action plans and regional co-operation. (See section III of this memo.)

³ See the Addendum sent by the General Secretariat of the Council to the Delegations on 22 January 2010, on regional cooperation.

II. Why member states weaken the gas supply security standards

10. The negotiation so far has resulted in a significant weakening of the standards, and the process is probably not over.
11. The fact that the “N-1” rule on the capacity of the supply infrastructure is highly disputable as an indication of gas supply security makes it easier for member states to justify weaker versions, but they would have weakened any rule. This is because in any case, an approach based on standards would mandate an *arbitrary level of security*.
12. There are very good reasons why member states resist such an approach. Let’s define gas supply security as the ability to meet final contracted energy demand in the face of a gas supply disruption. All member states already enjoy a certain degree of security which can always be increased, at a cost. Because the cost of attaining any given level of security can differ widely between countries, *the sensible level of insurance will be country-specific*. Moreover, most member states know little about this cost. Therefore, even if one assumes that social attitudes towards energy supply insecurity are the same everywhere, member states are bound to resist a centrally-defined minimum level of security – that is, unless they are absolutely certain to be above it already.
13. It is important to note that member states that are already very secure have no reason to push for tougher standards because *gas security is not a pan-European public good*: insecurity in Sofia, Riga or Warsaw does not translate into insecurity in Paris, Berlin or Rome; reciprocally, security produced in Slovakia can not be free-ridden upon in Slovenia. Even if all member states were ready to spend time and money on this problem (and there is currently a lot of goodwill and genuine interest all over Europe), given the nature of the issue at hand they would resist the imposition of a centrally-defined, meaningful standard.
14. Given the importance of security standard in the Commission’s proposal, there is a risk that, as they keep being weakened through the negotiation, the final version will be substantively empty, irrespective of how formally sophisticated it is. This is reminiscent of the negotiation that produced the notoriously benign Directive 2004/67, the original version of which did include a meaningful gas supply security standard⁴.
15. Gas supply security standards are appealing at first glance but are extremely difficult to devise and, more fundamentally, they are bound to be resisted by most member states. The other approach present in the Regulation, based on national gas security assessments and the negotiation of national action plans, is a more promising way to ensure that all EU member states address this problem adequately. A clear choice should be made in favour of the latter approach; standards could still be proposed as part of a methodology to perform

⁴ See COM(2002) 488 Final, 2002/0220 (COD), article 4.

the security assessments, but not as a tool to mandate a minimum level of security across the EU.

III. An innovative European policy process

16. The Regulation should set up a bottom-up policy process associating member states, the Commission and independent experts working on a regional basis. This proposal builds upon what is already present in the latest versions of the proposal under the headings “risk assessments” and “regional co-operation”.
17. The policy process would serve the following purposes:
 - a. Reveal the gas security situation in all member states;
 - b. Increase and share knowledge among member states about gas security policies and measures, including their cost;
 - c. Incentivise national governments to make gas security policy choices that are economically sensible and politically responsible.
18. To that effect, the Regulation should:
 - a. **Mandate in-depth national gas security assessment reports.** The reports should include:
 - i. An evaluation of the level of security enjoyed by the country, that is the ability of each member states’ energy system to meet final contracted energy demand in the face of gas supply disruptions of various severity, length and probability. This supposes a detailed appraisal of the policies in place, on top of an analysis of the risks of supply disruptions.
 - ii. An evaluation of the cost of improving gas security through various policy options.

The Regulation could propose some guiding standards to frame the gas security assessment reports. Referring to ‘one-in-*X* years’ peak demand periods is clearly sensible. Referring to the loss of the major inflow into the gas system also makes sense, though the specific “N-1” ratio currently proposed in the Regulation is clearly not sensible for many countries⁵. Generally speaking, member states

⁵ The focus on the largest infrastructure may not be the best approach; for about half the member states the sensible question to ask is “what happens if the Ukrainian corridor is disrupted”, not “what happens if the largest pipe into the national system explodes” (alternative gas may come through the same pipeline). Moreover, the focus on capacity is problematic because it only indirectly relates to security of supply.

should be advised to evaluate under what circumstances they would have to start interrupting gas customers involuntarily, and how likely those situations are.

- b. **Create regional gas security groups.** The national assessment reports would be carried out in the context of regional gas security groups. It would ensure a degree of methodological consistency in the assessments among countries that have somewhat similar gas supply set-ups and face similar risks (especially reliance on the same transit routes). They would also ensure a level of mutual support and be conducive to increased regional co-operation. Beyond the production of the national assessment reports, the regional groups would act as permanent platforms for member states to share knowledge and learn about gas security and associated issues. Regional groups would receive the support of third-party experts from international organisations, universities and consultancies. The Commission would participate as an observer.
- c. **Mandate national gas security action plans** to be attached to the assessment reports. In the action plans governments would explain whether they are satisfied with the level of security they enjoy and, if not, how they intend to increase security of supply and over what timeframe. The national action plans would include an evaluation of the cost of the proposed measures and how they could be financed. The national action plans may include measures carried out in partnership with other member states and include joint proposals on how to share the cost.
- d. **Mandate a review of the assessments and action plans**, carried out by teams of independent experts under the responsibility of the Commission. Based on these independent reviews the Commission would send written comments and suggestions to the national governments. These could include, where relevant, advice on subsidies or preferential loans that could be requested from European institutions in order to implement a more ambitious gas security policy than the one proposed in the national action plan.
- e. **Mandate that all the assessment reports, the action plans, the reviewers' reports and the Commission's comments and suggestions be made publicly available** on the Commission's and national governments' websites. This is very important if the governments are to be held responsible for their gas security choices by national politicians and opinion leaders.
- f. **Mandate a regular update of the assessment reports and review process**, for example every five years.

IV. Simplifying the Regulation

19. Gas security is about meeting final contracted energy demand in the face of a gas supply disruption or extreme weather events. Situations may happen that go beyond what a member state has insured against and customers may have to be interrupted involuntarily (that could be defined as energy *insecurity*). The Regulation asks member states to define a category of “protected customers” including households at a minimum, which would have their supplies guaranteed for a number of days in case of extreme weather events or supply emergency (what the Commission called the “supply standard”). Moreover, the Regulation proposes a complex architecture whereby crises of various severities would be dealt with at various institutional levels and with measures that are “market-based” or not.
20. Those categories will prove very difficult to define precisely for technical and political reasons; it may not even be possible to answer the questions that member states are supposed to answer in their “emergency plans” (which type of measures would be used to address what type of emergencies). Moreover, the set up proposed by the Regulation to characterise and manage gas supply crises is almost certainly impractical, apart from being politically contentious⁶. In particular, it is not clear that declaring a “European emergency” would improve the ability to manage a crisis in the event that spontaneous contractual mechanisms and administrative measures implemented by member states still left some final energy demand unmet.
21. It seems that a few simple dispositions would be sufficient to improve emergency preparedness at member state and regional level and would allow a drastic simplification of the Regulation. Given that the whole process described in section III of this memo is designed to make sure that all member states buy an appropriate level of insurance, the Regulation should abandon the reference to “protected customers” and deal with the issue of ‘gas insecurity management’ by mandating the following on member states:
 - a. All member states should include, in their network codes or other publicly available documents, clear and non-discriminatory procedures to interrupt different categories of gas consumers, should this be required to manage a gas crisis.
 - b. All member states should carry out, at least once a year and under the responsibility of the ministry in charge of energy, the energy regulatory authority or another institution, gas emergency drills. These tests could involve, among other aspects, the activation of interruptible gas contracts, the shifting of power

⁶ A coalition of large member states, including several of the largest gas markets in Europe, have recently asked that the power to declare a “Community emergency” rest with the Council, not the Commission.

plants to alternative fuels and the (involuntary) interruption of different categories of consumers. They should also include the practice of emergency regional coordination, including simulation of gas flows when the Ukrainian corridor (or another supply infrastructure of regional significance) is disrupted.

22. Finally, the Commission should be commended for emphasising the importance of letting the internal market work in times of crisis. However, there is a risk in enacting specific prohibitions, clearly motivated by a few well-known national measures (but leaving unaddressed many other barriers to gas trading in Europe), that the Commission may not be able to uphold in front of a legal challenge; the whole Regulation may be weakened. The following approach could be preferable:

- a. The recitals of the Regulation should reaffirm that a pan-European wholesale market for gas would have immense benefits in terms of supply security. It would make it easier and cheaper for any member states to attain a given level of security.
- b. The text should reaffirm the legal principles that underpin cross-border transactions (be it gas contracts, transmission capacity contracts, or storage capacity contracts) and state that the Commission is going to actively pursue their enforcement against any provisions that would distort the internal market in the name of gas supply security.

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