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Research Report

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Effective Provisions for Emergency Prevention and Response in the Gas Sector

Pioneering Proposals of the Commission for a New Risk-Management Architecture

Oliver Geden

In July 2009 the EU Commission presented a Regulation proposal on crisis management in the natural gas sector which has the potential to initiate a paradigm shift in European energy security-of-supply policy. After years of futile attempts to create a common external energy policy, a phase could now ensue in which the EU increasingly becomes aware of its internal options for action. The risk-management architecture developed by the Commission will contribute to make the debate on energy security more objective. If all member states are to achieve a standard level of provisions, as the draft intends, they will be obliged to develop a pragmatic security-of-supply policy. Attention will no longer be fixed on just a few symbolic major projects, as it was in the past; the focus will be more on sober cost-benefit considerations for a large number of rather unspectacular options for action.

When the EU discusses the security of gas supply, all eyes tend to look abroad. For years the problem was identified as being with supplier countries, first and foremost Russia. Awareness of the significance of transit states such as Ukraine has grown since early 2009, but this has done little to change the dominant, erroneous habit of equating supply security with external energy policy.

The EU's security of gas supply is determined by many variables. Import pipelines and terminals for liquefied natural gas (LNG) are important pieces in the mosaic but they alone do not give a full picture. Equally important are factors that will

influence the EU's volume of future gas demand and the flexibility of European market structures. These include increased energy efficiency, the expansion of renewable sources of energy, the creation of an internal market for gas and, last but not least, the establishment of effective crisis-response mechanisms.

Deficiencies within the EU

The most recent Russian-Ukrainian gas conflict led to considerable gas-supply disruptions to Central and South-Eastern Europe. This was attributable partly to the failure of the states affected to make

adequate provisions and partly to the yet insufficient development of the European internal market for energy. Not only does the region lack natural gas storage facilities and functioning contingency plans but there is also a shortage of pipeline connections and intergovernmental coordination bodies. Sufficient amounts of gas were available within the EU at every point in the crisis. But transporting this gas to the countries particularly affected by the delivery failures was either not possible or involved great delay.

The EU's internal deficiencies revealed in January 2009 came as no surprise. They had already been detected by the Commission several months earlier in an evaluation report on Directive 2004/67 ("on measures to safeguard security of natural gas supply"), which is currently still in force. But the fear of a new escalation of the energy conflict between Russia and Ukraine has considerably strengthened the readiness of the Council of the EU and the European Parliament to swiftly develop an effective system to provide against short-term disruptions of supply.

The Primacy of Flexible Provisions by the Member States

The Regulation proposal now presented by the Commission aims to achieve a standard level of risk management among all member states. The plan centres around the "n-1" principle according to which, even if a country's main gas infrastructure fails, it must still be in a position to supply private households and other "protected consumers" such as schools and hospitals for another sixty days – even during a period of extremely cold weather that statistically occurs only once every twenty years. In order to fulfil this undoubtedly ambitious guideline the member states would first be obliged to carry out a detailed risk assessment for various disruption scenarios. They would then prepare a prevention plan for the Commission, to be updated at regular intervals, outlining

the measures they have planned to guarantee the future fulfilment of the sixty-day criterion.

In terms of the provisions to be made by the member states, the Commission's proposal allows a very high degree of flexibility. Its sole principle is that "market-based measures" should always have priority in ensuring secure gas supplies. These may include commercial gas storage, the diversification of suppliers and transport routes, the expansion of the gas network capacity and the development of the technical prerequisites for reverse flow in transit pipelines. However, measures to influence gas demand are of equal importance. Member states are thus at liberty to improve their crisis-preparedness through an ambitious efficiency policy or the expansion of renewable sources of energy, e.g. by promoting the production of biogas. Additionally there is the option already established in the gas industry of "interruptible contracts", under which large consumers of natural gas must be prepared to switch to a different fuel or temporarily close down individual plants if there are bottlenecks in supply.

The Commission holds that "non-market based" instruments such as state-controlled compulsory stockpiling (*strategic storage*) or an enforced switch to different fuel sources may only be used in an emergency. The contingency plans to be presented by the relevant bodies of the member states must lay down in advance what measures will be taken if supply is interrupted and what effects the measures are expected to have. In practice, the prime responsibility for security of supply lies with the gas industry, and this is to remain so in future; provisions of the member states are intended merely as an addition. The regulatory authorities can decide themselves, as the situation requires, when to declare a national emergency. But the Regulation proposal entitles the Commission to declare an "EU-wide emergency" when even relatively low thresholds are exceeded. The Commission would then assume the

authority to coordinate the national bodies and would also be empowered to issue them a wide range of directives.

A Goal-Oriented Policy Approach

The guideline of ensuring the n-1 criterion would hardly be a worry for Germany, which in terms of gas supply is broadly diversified, well interconnected with its neighbours and exceptionally well equipped with gas storage facilities. But the Regulation's approach of focussing specifically on the obligation of each member state to make provisions would place considerable strain on many Eastern European states – not only would they have to draw up and present detailed risk assessments for the first time but they would also need to enlarge their national regulatory authorities and, in some cases, make considerable investments in infrastructure. The proposed risk-management architecture would lead to a partial depoliticisation of energy security issues throughout Europe. If the governments of the member states have to explain to the Commission which country-specific packages of measures they intend to use to ensure the fulfilment of the sixty-day goal, this will essentially force them to follow a cost-benefit logic and take steps oriented primarily towards the efficiency of each instrument. Security-of-supply policy could then no longer be limited to verbose complaints about the behaviour of Russia as main supplier (or sole supplier, as the case may be) while waiting for visionary pipeline projects to come online. If the Commission puts through its proposal, this will lay the foundation for an evidence-based system of risk management, which could lead the member states to adopt a pragmatic policy of well-tailored steps and thus also protect them from investing political energy and financial resources in projects that may be highly symbolic but are oversized in terms of their own supply structure. For example, not every littoral state needs its own LNG terminal. Often it suffices to extend existing

networks into appropriately equipped neighbouring states. But the growth blip to be expected as a result of the financial crisis and the effects of the ambitious EU Energy and Climate Package make it safe to assume that forecasts for European gas demand will gradually be adjusted downwards.

Energy Supply Security in the Internal Market

The measures to establish a European crisis-management architecture will only be efficient if they complement the creation of a functioning internal market for gas, which has been slow to materialise, and do not aim to replace it. The “unbundling“ of integrated energy companies is of decidedly secondary importance. If the internal market itself is to become an effective instrument of energy supply security, attention must be directed towards a stronger infrastructural interconnection of member states' energy markets and the Europe-wide harmonisation of the trading rules and network codes, in short: towards the coordinated development of a European pipeline grid subject to uniform energy-market regulation. In a European internal market for gas, households and businesses would be significantly better protected against the risk of supply interruptions than they are today. As long as reserve capacities are available somewhere in Europe, these would be delivered in crisis situations – provided the price is right.

This market mechanism should not be confused with the principle of energy solidarity, which has been on everyone's lips in the EU lately. If the economically weaker member states are also to be able to rely fully on intra-European support, there will need to be binding rules to complement market forces. Contrary to the Commission's current intentions it would therefore have to be possible in extreme circumstances to oblige member states with a better supply situation to make their reserves available to partners who have run into trouble through no fault of their own –

similar to the oil crisis mechanism of the International Energy Agency (IEA). Only this will allay the fears of many Eastern European states that they could deliberately be subjected to blackmail by a gas-producing country.

Conflicting Interests

The first reactions to the Regulation proposal exhibit one of the classic conflict configurations in EU policy. A majority of national governments raise the criticism that the proposal attributes far too much competence to the EU Commission. The Regulation would apply directly and be legally binding in all twenty-seven EU states, and critics say this would undermine the member states' responsibility of ensuring energy supply security codified in EU primary law. Already there are indications that a group of member states will use the coming negotiations to work towards converting the Regulation into a Directive, as this would give them more leeway in the national organisation of crisis management. Since the Commission's proposal is based on the chapter of the EC Treaty concerning the internal market (Article 95), the European Parliament is also involved through the co-decision procedure. Even if the newly elected Parliament is as pro-integration as its predecessor, it is still likely that the original proposal will be substantially watered down during the legislative debates. It seems likely that these alterations will affect not only the very broad powers of the Commission but also the thresholds for declaring an EU-wide emergency or the extent of the transparency obligations of the gas-supply companies.

It is indispensable for the success of European energy security-of-supply policy, however, that the basic risk-management architecture remain intact, i.e. the obligation of every member state to be in a position to mitigate the failure of its main infrastructure for sixty days according to the n-1 principle. Implementation of this

obligation will significantly increase the security of gas supplies in the EU; moreover, it will make the discourse on energy security more objective and help accelerate the expansion of the European internal market for gas. The elaboration of a uniform external energy policy would still remain on the agenda, but all these internal developments would certainly facilitate the EU's ability to "speak with one voice" towards its external energy suppliers.

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