ENERGY POLICY WEEKLY
Policy & Regulation from Brussels and beyond

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Šefcovic vows to 'explore' common gas purchasing

European elections

THE European Commission's Vice President for Energy Union, Maroš Šefcovic, has pledged to explore the idea of creating a single purchaser of gas on behalf of EU member states. Addressing MEPs in the European Parliament this week, the 48-year-old Slovakian said Brussels must "explore common purchasing of gas", although he underlined the importance of respecting international competition law under the World Trade Organization.

With a clear reference to Moscow, Šefcovic said EU countries must secure "much better treatment [and] much better price" when negotiating long-term gas contracts. "We are the biggest energy customer in the world, [but] are we behaving like that?" Šefcovic asked MEPs.

Šefcovic was only given five days to prepare for the public hearing in Strasbourg after President-Elect Jean-Claude Juncker nominated him as vice president following the withdrawal of Alenka Bratušek, former prime minister of Slovenia (see *Energy union suffers setback after Bratušek rejection*, 9 October 2014). Šefcovic had originally been nominated as commissioner for transport and space; however, Bratušek's withdrawal forced a reshuffle after it became clear she did not have adequate support from MEPs.

'Single buyer' solution

The idea of a common purchaser of gas on behalf of all member states was originally launched by Donald Tusk, the Polish prime minister and incoming president of the European Council. It is seen as a controversial idea and does not have support from key member states – including the UK and Germany. However, the proposal has the backing of senior officials within the commission.

Miguel Arias Cañete, the new commissioner for climate action and energy, said during his public hearing in parliament that he would support the idea of 'joint negotiating' if it was in line with WTO trade rules. (see *Industry concerned over Cañete's calls for single gas buyer*, 9 October 2014).

At this week's public hearing in Strasbourg, Šefcovic told MEPs he supported binding targets for energy efficiency and hoped member states would strike an ambitious agreement for 2030 energy and climate targets at the council summit this week.

Asked whether he was in favour of a more ambitious renewables target by 2030 than the 27% EU-wide target tabled by the commission, Šefcovic said: "There are several countries that would like to go over the 27% target – I believe Europe will overachieve this target."

Regarding the South Stream pipeline, Šefcovic echoed the view of outgoing energy commissioner Günther Oettinger. He said the project must comply with EU competition law and did not strengthen security of supply in the EU.

Work on the Bulgarian section of South Stream was suspended earlier this year following pressure from the EU. "There is a good reason for [the suspension] because we simply cannot accept that such a big project could be taking place in the EU by a company which does not want to respect European rules," Šefcovic said.

He added: "Russia is increasingly using gas supply as an instrument of pressure and as a political weapon against Ukraine and other countries who want to help [it]. That is totally unacceptable." ■

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Profile: Maroš Šefcovic

- Expected to take office as the European Commission's Vice President for Energy Union on 1 November.
- Born in Bratislava, Slovakia in 1966
- Former ambassador to Israel and permanent representative to the EU. Served as commissioner for education, training, culture and youth between 2009-2010.
- Wants to consider single purchaser of gas. Supports binding energy efficiency targets and carbon capture and storage research.
- Supported the commission's decision to allow state aid regime for Hinkley Point C nuclear power station in the UK.

Sources: Maroš Šefcovic, European Parliament, Interfax

China and US will make or break climate deal

Environmental policy

THE EU could provide an important signal to world leaders if its heads of state agree on a 40% greenhouse gas (GHG) reduction target at the European Council meeting in Brussels this week. However, it will be China and the United States that will decide whether a binding agreement on GHG emissions is agreed at the following UN summit in December.

The Conference of Parties 15 summit, to be held in Paris, has been labelled the most important negotiation ever. It will decide how the remaining 'carbon space' that can be emitted globally while staying below a 2 C warming level will be divided among the countries of the world.

"What the EU leaders agree this week at the council is hugely important for the Paris summit. In Paris we need a final number, agreed by all parties – a meaningful deal with legal force," Elina Bardram, head of the Directorate General for Climate Action's International Unit, said at an event in Brussels.

According to Brigitte Knopf, head of Energy Strategies Europe and Germany at the Potsdam Institute for Climate Impact Research, the effort-sharing – how the 40% GHG reduction should be divided among EU states – will probably remain unclear and is unlikely to be decided at the council meeting.

"Part of the EU's GHG reductions are covered by the Emission Trading System (ETS). However, the functioning of the ETS is currently questioned and the suggested ETS reform is not comprehensive enough to raise the price of allowances. We therefore suggest a minimum price for carbon be introduced," Knopf said.

Jairam Ramesh, India's chief climate negotiator, recently said it is important that the US and China create a "broad framework of action" at the 2015 meeting.

"India could well be the last man standing in Paris; China and the US are engaged in bilateral discussions and the Chinese have nuanced their traditional hardline position," Ramesh said in October at Harvard University.

Both countries have been reluctant to sign global deals, but relations between the US and China are decisive for any potential deal, according to Karl Hallding, senior researcher at the Stockholm Environment Institute.

US position

While the US has not announced an official position for COP 15, Washington is expected to offer up a preliminary goal for the US by the end of March.

"It is unclear whether that will be a numerical target, or a set of policies and measures," John Reilly, climate change expert at MIT, told *Interfax*.

The US position on GHG reductions and supporting an international agreement appears stronger than ever, according to Lynn Grayson, a partner at the Chicago-based Jenner & Block law firm.

"Last month, the US State Department submitted a possible global climate change agreement to the United Nations Framework Convention on Climate Change supporting a five-year timeframe to make initials cuts to carbon emissions, beginning in 2020 and ending in 2025," she said.

If a new agreement would take the form of a treaty, it would require approval of two-thirds of the US Senate for ratification.

"Given the workings of Congress these days, it is very unlikely that any treaty could be ratified. It would be virtually impossible to receive the votes needed for approval," Grayson said.

For this reason, President Barack Obama's administration is pushing for a politically binding agreement or accord, which would not be characterised as a treaty and would not require ratification from the Senate or other governing bodies around the world.

The US Environmental Protection Agency put forward a proposal in June requiring the electric power sector to cut its carbon emissions by 30% from 2005 levels by 2030 (see *Obama's emissions plan gets nod from Brussels*, 5 June 2014).

"It is likely that the administration will 'tot up' the various measures it has put forward in the Clean Air Act and offer a reduction they believe this will achieve. This might be 25% or 30% below 2005 by 2030," Reilly added.

Much will also depend on how successful the administration is in defending in court the climate policies it has already proposed against those who believe the administration has overstepped its authority under the Clean Air Act.

China

According to Hallding, there are "hopeful statements" about China being more progressive on climate action, but generally positions are fixed and polarised, he told *Interfax*.

"It is wishful thinking [that they would] achieve any deal early – the different parties will keep their positions for as long as possible," he added.

However, according to Hallding, China is initiating numerous actions to reduce its reliance on coal as fast as possible and the debate about 'coal peak' is intensifying – including the growing realisation about the side effects of coal use, including air quality and supply constraints.

A large overcapacity in heavy manufacturing, particularly in the steel industry, has built up and ambitious policies are being implemented in China to shut down steel production. ■

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Climate summit timeline

December 2014
UN climate negotiations in Lima to discuss the post-2020 agreement and pre-2020 action

Early 2015
Countries submit proposals on targets and contributions to the UN by March 2015, to be reviewed in advance of the Paris summit

December 2015
Paris climate summit

EU considers aid to modernise coal-fired power plants

Environmental policy

EU countries will discuss a funding regime to modernise some of Europe's most-polluting power plants when they meet in Brussels this week to discuss energy and climate targets for 2030.

EU countries – led by Germany, the UK and France – will try to reach an agreement on a 40% CO2 reduction target compared with 1990 levels by 2030 to have a firm negotiating position ahead of the global UN summit in Paris next year. However, some lower income countries – including Poland – may be offered financial aid to modernise their energy systems in a move to get them to agree to the 40% agreement, according to EU diplomatic sources.

"We have foreseen a new reserve in which some member states receive some funding to modernise their energy systems," said one senior EU diplomat.

Maroš Šefcovic, the commission's newly elected vice president for energy union, made similar comments at a public hearing in Strasbourg this week.

"I believe we can use the support for new carbon capture and storage technologies and also the investment fund which I believe will be created [to] help Poland renew their power stations so that they are much, much cleaner than they are right now," Šefcovic said.

At the time of writing, it is not clear how big the fund will be, nor how the funding mechanism will work in practice. However, convincing Poland and other Eastern European countries to commit to ambitious climate targets has long been seen as a major challenge. Electricity in Poland is mainly generated from ageing and carbon-intensive coal-fired power plants.

Six Eastern European member states – Poland, the Czech Republic, Romania, Bulgaria, Hungary and Slovakia – have called for effort-sharing across all sectors, not just those covered by the EU's Emissions Trading System (EU ETS). The ETS sector includes power and industrial plants, while the non-ETS sector includes transport and buildings.

Effort-sharing means some member states commit to higher CO2 reduction targets than others. However, EU sources have said effort-sharing is only an option in the non-ETS sector, as was the case with the 2020 targets.

Deal could be made

Despite the differences in opinion, an EU agreement on CO2 cuts for 2030 could be reached on Thursday evening.

"Differences of opinion have been narrowed down to a couple of outstanding issues that will be settled on Thursday night," said the diplomat. "I am pretty confident that we will be able to find a solution."

If this week's council summit produces an agreement on CO2 cuts, it could be significant for investments in gas-fired power plants and technologies such as carbon capture and storage (CCS). Moreover, it would increase the likelihood of a global agreement on CO2 cuts in Paris next year.

The 40% target – proposed by the European Commission earlier this year – is seen as a minimum commitment to reach the EU's long-term ambition of cutting its greenhouse gas emissions by 80-95% by 2050 compared with 1990 levels.

"The 40% CO2 reduction target by 2030 is not enough to reach full decarbonisation by 2050, but it is close to the maximum we can get political support for at a national level," Georg Zachmann, a research fellow at Brussels-based thinktank Bruegel, told *Interfax* earlier this month (see Q&A: New commission must stop renationalisation trend, 2 October 2014).

Regarding energy efficiency, however, it remains uncertain whether this week's summit will produce a firm agreement beyond 2020. Earlier this year, the commission proposed a 30% target by 2030, but it remains highly unclear whether the target will be legally binding or not. The commission sees energy efficiency as a key tool to reduce energy imports from third countries such as Russia, but a 30% target would be expensive, according to sceptics.

"The introduction of any legally binding renewable energy or energy efficiency targets at national or EU level is not desirable," said a joint statement from the six eastern European nations.

A legally binding renewables target at national level – as was the case for the 2020 package – nevertheless seems unlikely. The commission has proposed an EU-wide target of a 27% share for renewables in energy consumption, but no national targets. ■

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2030 targets

The leaders of the 28 EU member states will meet in Brussels on Thursday and Friday to discuss energy and climate targets for 2030. These are:

- A 40% cut in GHG emissions (compared with 1990 levels)
- A 30% energy efficiency target
- A 27% share for renewables in energy consumption
- A 15% interconnection target in electricity

Source: European Commission, Interfax

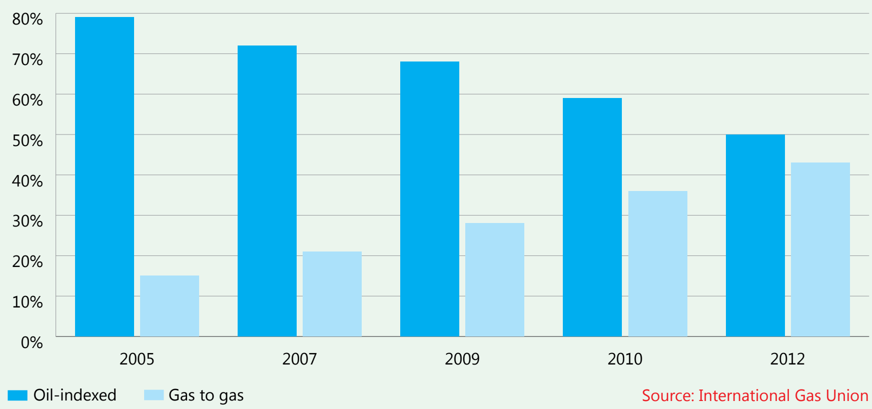
News in brief

The European Commission is hopeful **Russia** and **Ukraine** will reach a final agreement on settling Naftogaz Ukrainy's debt to Gazprom by next week as well as a deal on gas deliveries for this winter, outgoing Energy Commissioner Günther Oettinger said in Brussels this week. "In the next meeting – which we hope will be the final [one] – next Wednesday here in Brussels, we will be able to reach a decision and have the signatures of all the partners," Oettinger told journalists after the negotiations on Tuesday. At the meeting it was agreed Ukraine would settle its debts based on a preliminary price of $268.5/Mcm ($7.31/MMBtu) by making payments in two tranches: $1.45 billion by the end of October and $1.65 billion by the end of the year.

Hungary gas renegotiation could affect long-term pricing

Energy security

Wholesale gas price formation mechanisms in Europe



Source: International Gas Union

RENEGOTIATING Hungary's 19-year gas contract with Gazprom – which will expire in 2015 – could also affect negotiations between other European member states and Russia, according to experts.

"Some European countries are facing sharply reduced gas demand and their markets are over-contracted by long-term obligations – this trend could impact renegotiations of Russian contracts," Peter Kaderjak, director at the Regional Centre for Energy Policy Research, said at an event in Brussels on 15 October.

Presenting a new study on energy security, Kaderjak said increasing energy efficiency and use of renewable energy have already reduced gas demand and could decrease it further, which will affect gas contracts.

"Hungary's long-term contract runs out next year; it will be interesting to see if a new long-term contract or a contract based on a spot market pricing mechanism will replace it," Kaderjak added.

Hungary's Panrusgaz signed a contract with Gazprom for the period between 1996 and 2015. According to Gazprom figures, gas deliveries to Hungary reached 5.97 billion cubic metres in 2013, delivered along two routes – through Beregovo on the Ukraine-Hungary border, and Baumgarten on the Slovakia-Austria border.

However, Gazprom is keen to continue oil-indexed contracts and has not significantly shifted its position – unlike Norway, which has moved to spot-indexed pricing mechanisms, according to Nick Perry, senior adviser at Timera Energy.

Cash rebates

"Gazprom has given significant cash rebates to reduce the overall price in long-term contracts instead of switching to spot-pricing mechanisms – and is also willing to move to minimum volumes in contracts, rather than see gas put on the spot market," Perry told *Interfax*.

Perry also does not expect an 'energy union' – which could include a single purchaser of gas on behalf of all member states – to change contract negotiations.

"'Divide and rule' is a significant part of Gazprom's negotiations strategy and they have avoided any other forms of joint negotiations," Perry said.

"In addition, I cannot see why Germany or France, both having a very strong solo negotiating position, would be willing to give it up for a joint EU purchasing body," he added.

The ability of countries that are largely dependent on Russian gas to diversify their supply sources would ultimately have a larger effect on negotiating positions, according to Perry.

Nevertheless, spark spread levels are driving combined-cycle gas turbines out of the market, which could mean lost business for suppliers, according to Kaderjak. "Maybe suppliers could index gas prices to electricity prices instead of oil prices," he said.

The European Parliament stepped up its efforts to phase out oil indexation in gas supply contracts after adopting a non-binding resolution on the internal energy market in 2013 (see EU Parliament ups pressure to phase out oil indexation, 19 September).

Just under 50% of long-term take-or-pay gas supply contracts to Europe are indexed to oil. This is expected to fall further because of diverging spot and oil-indexed prices.

But although Gazprom has agreed price cuts with several of its EU customers, only 7% of its supply contracts are indexed to hub prices. Oil indexation in gas contracts is one reason why gas prices are far higher in the EU than in the United States. ■

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News in brief

Members of the European Parliament have approved the 27 commissioners proposed by **President-elect Jean-Claude Juncker** with 423 votes in favour, 209 against and 67 abstentions. Following the vote, Miguel Arias Cañete will become the EU's commissioner for climate action and energy. After MEPs rejected Slovenia's Alenka Bratušek, Slovakia's Maroš Šefcovic will become the EU's new energy union vice president. Diversification of gas supply, 2030 energy and climate targets and reform of the EU Emissions Trading System are some of the urgent issues the new European Commission will have to deal with. The new commission will have to be formally appointed by EU heads of state or government to enable it to take office on 1 November for a five-year term.

Retail vs wholesale price divergence continues – ACER

Market legislation

RETAIL prices for gas and electricity continued to rise in 2013 despite a general decline in wholesale energy prices, a report confirmed this week.

The average household electricity bill increased by 4.4% across the EU while gas prices rose by 2.7%, according to the report, published by the Agency for the Cooperation of Energy Regulators (ACER) and the Council of European Energy Regulators.

"Despite weakness of demand, electricity and gas prices are increasing for households and industrial users," ACER Director Alberto Pototschnig told a press conference in Brussels at the report's presentation.

He said regulated retail prices in many member states remain a barrier to entry for new suppliers. The Second Energy Package, adopted in 2003, abolished end-user price regulation for non-household customers by July 2004 and for all customers by July 2007. The Third Energy Package, adopted in 2009, authorised price regulation for vulnerable customers. (see *Price caps, subsidies blamed for tariff deficits* – EC, 9 October 2014).

Pototschnig urged member states to phase out regulated prices for non-vulnerable customers as soon as possible.

"If regulated prices are below cost they represent a barrier to new entry," he said.

The report identified a fall in wholesale energy prices as a result of the higher penetration of renewables and cheap coal from 2011 onwards. On wholesale gas competition, the report said a lack of liquidity at European hubs – with the exception of the NBP in the UK and the TTF in the Netherlands – remained an issue.

Lack of liquidity

"Liquidity is still an issue in many countries. I think we only have two liquid hubs: the UK and the Netherlands," Pototschnig said. "However, we are seeing improvements."

Citing data from the International Energy Agency, the report said aggregated Russian exports to Europe increased by 15% year on year in 2013 to roughly 155 bcm. It said the increase was partly explained by Gazprom's willingness to renegotiate contract prices with the aim of better utilising spare capacity.

"This may have been in response to its loss of market share to more flexible competitors – i.e., Norway – in previous years, or in the anticipation of the price reduction effects from increased competition," the report said.

The switch from oil indexation to spot indexation in long-term gas contracts has continued, and has contributed to greater price convergence and downward pressure on wholesale prices, the report said.

However, significant price differences remain between EU member states as some have more bargaining power with suppliers than others. Oil-indexed and semi oil-indexed long-term contract prices also remain more common in Central-East and Southern Europe than elsewhere in the continent, the report said. ■

ACER, CEER report at a glance

- Divergence between wholesale and retail energy prices continues
- Liquidity at most gas hubs remains low
- Gap between long-term contracts and hub prices is declining
- Switch from oil to spot indexation in long-term contracts continues
- Increased hub price convergence and lower prices caused by switch from oil indexation

Sources: ACER, CEER

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EC clears InfraVia's 20% purchase in Noordgastransport

Mergers & acquisitions

THE European Commission has cleared InfraVia European Fund II's purchase of a 20% stake in Dutch gas grid company Noordgastransport, it said this week.

InfraVia European Fund II is owned by OFI InfraVia – a French investment company – and controlled by the Macif Group, a French insurance company. OFI InfraVia bought the 20% stake from GDF Suez for an undisclosed sum. It will jointly control Noordgastransport with the existing shareholders GDF Suez and PensionDanmark Holding.

The 42 million cubic metre per day (MMcm/d) grid carries gas from the Dutch sector of the North Sea to a treatment terminal in Uithuizen on the north coast of the Netherlands, from where it is distributed through the Dutch gas network.

"The commission concluded the proposed acquisition would not raise competition concerns [given the absence of] any horizontal overlap or vertical relationship of [InfraVia's] activities. The operation was examined under the simplified merger review procedure," the commission said in a statement.

The acquisition is further evidence of the increasing appetite of pension funds and insurance companies for European energy infrastructure assets. Funds seeking a diversified portfolio are attracted by the long-term, stable returns investment in gas infrastructure assets can potentially offer (see *Pension funds eye EU gas infrastructure*, 9 August 2013).

The commission cleared PensionDanmark's 40% stake in Noordgastransport from Abu Dhabi-based energy company TAQA in December last year. The stake was sold for €171 million ($218 million).

In October the same year, the commission approved Dutch pension fund PGGM's acquisition of a 33% stake in Northern Offshore Gas Transport (NOGAT). PGGM now has joint control over NOGAT, with EBN of the Netherlands and GDF Suez. ■

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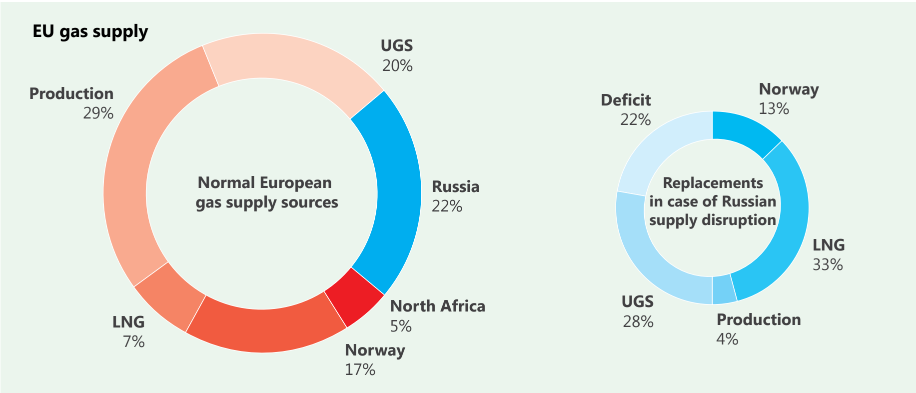
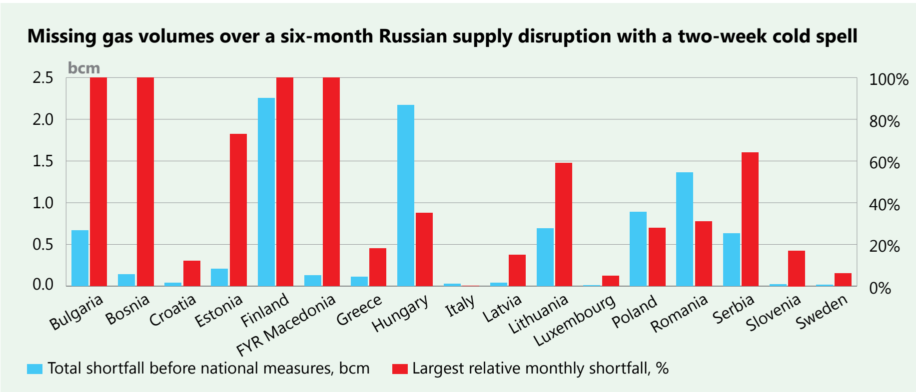
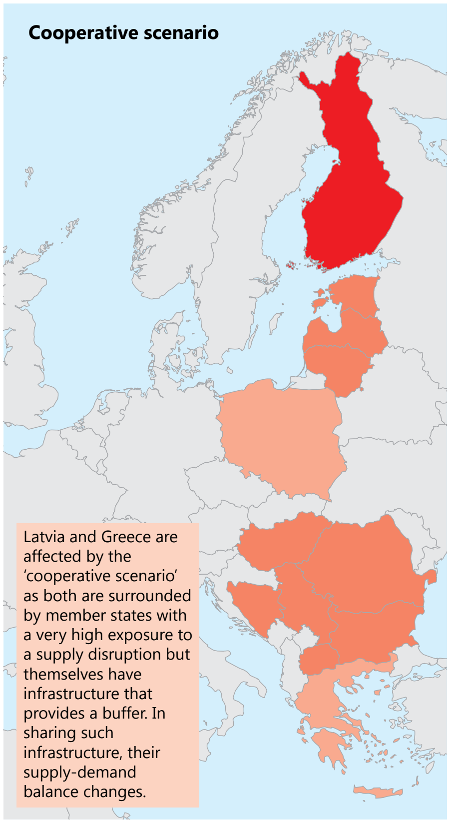
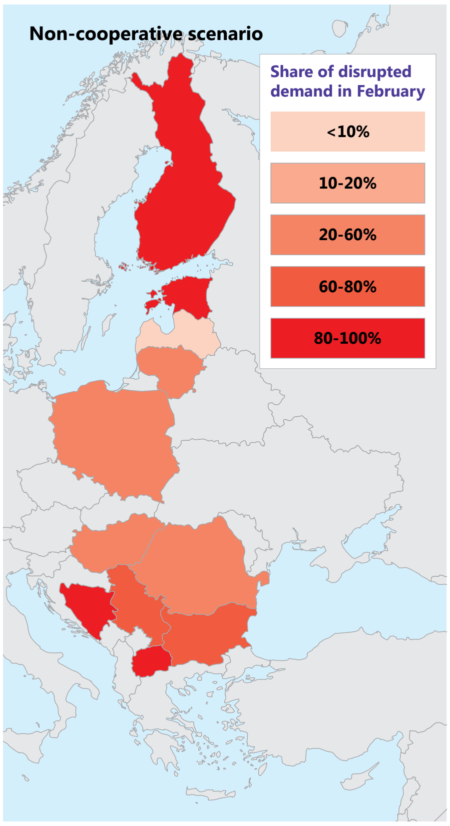
Stress test highlights disruption risks









Source: ENTSOG

Cooperation and LNG will allow European member states to maintain gas supplies in the event of a gas crisis this winter, the European Commission has said.

The commission published the results of the first ever Europe-wide 'stress test' study on 16 October. The study analyses the resilience of the EU energy system to a potential gas crisis.

Eastern European and Energy Community countries would be most severely affected – particularly Estonia, Latvia, Lithuania, Finland, Bulgaria, Romania and Hungary – the study found.

"If all member states cooperate with each other, however, protected consumers would remain supplied even in the event of a six-month gas disruption," Energy Commissioner Günther Oettinger said at the presentation of the study in Brussels.

The stress test showed LNG is a key way to increase supplies in case of serious shortfalls.

"However, procuring LNG spot cargoes expediently during a crisis can be both expensive and require some time," the study said.

"Therefore additional volumes of gas in storage or contracting some form of 'LNG insurance' – for example, in the form of LNG purchase options – can greatly reduce corporate exposure by hedging both price and operational risk," the study said.

Recent efforts by Japan and the commission to tackle high LNG prices could also lead to further 'cooperative agreements' between the two, the report said (see *Little optimism on EU-Japan LNG price cooperation*, 15 May 2014).

Annemarie Botzki
in Brussels