# Commission Consultation on an EU strategy for liquefied natural gas and gas storage[1]

## 1 Responses to consultation – LNG section

### 1.1 LNG in the EU today

*1. Do you agree with the assessment for the above regions in terms of infrastructure development challenges and needs to allow potential access for all Member States, in particular the most vulnerable ones, to LNG supplies either directly or through neighbouring countries? Do you have any analysis or view on what an optimal level/share of LNG in a region or Member State would be from a diversification / security of supply perspective? Please answer by Member state / region.*

Context used in paragraph 2.2 of the purposeful interpretation of the situation. The Ministry of Industry and Trade (hereinafter "MIT") and the Czech Energy Regulatory Office (hereinafter "ERO" or "Office") disagree with the inclusion of the Czech Republic (hereinafter "CR") among the most vulnerable countries for the following reasons:
a) The Czech Republic supports the diversification in the sense stated in basic document, but the Czech Republic has sufficient capacity of gas infrastructure through which it is possible to transport gas from other countries having access to the LNG.
b) The Czech Republic also was not invited and is not currently part of the initiative CESEC. CESEC is focused on identifying the minimal infrastructure, including LNG terminals, necessary to ensure the diversification of sources and elimination of dependence on a single supplier in Central and Southeastern Europe. Unofficial reason is that the Czech Republic does not belong to countries threatened by dependence on one gas supplier.

LNG terminal in Swinoujscie referred to in section 2.6 should also be included as a part of the North-South corridor in Central and Southeastern Europe under point 2.4. This terminal is an integral part of this gas corridor. Not only the construction of the LNG terminal itself, but also related infrastructure allowing access to this terminal is important for the region and for the Czech Republic. Generally, we deem that it should be emphasized that the primary obstacles would be removed, i.e. non-existent interconnection within the North-South Corridor. Furthermore, it should be taken such measures in order to eliminate physical shortage of capacity at interconnection points.

*Question 2: Do you have any analysis (cost/benefit) that helps identify the most cost-efficient options for demand reduction or infrastructure development and use, either through better interconnections to existing LNG terminals and/or new LNG infrastructure for the most vulnerable Member States? What, in your view, are reasons, circumstances to (dis)favour new LNG investments in new locations as opposed to pipeline investments to connect existing LNG terminals to those new markets?*

The MIT and the Czech ERO do not have any specific analysis of that issue. However, ERO continuously evaluates the situation based on publicly available information.

[1] Consultation published on 8 July 2015 at: https://ec.europa.eu/energy/en/consultations/consultation-eu-strategy-liquefied-natural-gas-and-gas-storage

As the main obstacles to development, we see the following factors:

a) the price of gas “produced” through LNG will always compete with the price of gas supplied "classical" way over pipelines
b) negative analysis of the costs and benefits (the "CBA") of individual projects;
c) the need for long-term contracts.

Generally, both the MIT and the Czech ERO deem that the LNG terminals should be treated by the same non-discriminatory manner as the other gas infrastructure projects, i.e. they should be constructed to be capable to cover their costs by their activities. In case of realization of too many terminals without adequate demand for LNG on the other hand, a situation may occur similar to the situation with gas storage facilities where their services will not be sufficiently demanded and, therefore, revenue will not be enough even to cover the costs of construction and operation, what will be leading to unnecessarily spent resources and time.

*3. Do you think, in addition to the already existing TEN-E Regulation, any further EU action is needed in this regard? Do you think the use of LNG gas and existing LNG infrastructure could be improved e.g. by better storage possibilities, better network cooperation of TSOs or other measures? Please give examples.*

The main measure of supporting the use of LNG infrastructure is the price at which LNG can be bought and subsequently transported to areas of consumption. In prices for the use of LNG infrastructure should not enter any costs that are not relevant to their activities.

*4. What in your view explains the low use rates in some regions? Given uncertainties over future gas demand, how would you assess the risk of stranded assets and lock-in effects (and the risk of diverting investments from low carbon technologies such as renewables and delaying a true change in energy systems) and weigh those against risks to gas security and resilience? What options exist in your view to reduce and/or address the risk of stranded assets?*

The key issue for customers may be the uncertainty in connection with the diversion from fossil fuels when it is not clear what will be the development of prices for individual eco-friendly fuels.
The solution is to provide investment subsidies and incentives in the regions that minimize investor risk associated with these projects and does not transfer the burden on the user of system, while the benefits are societal. However, there is a need for a high degree of caution as any subsidies or incentive may lead to distortions in the market and redistribution of funds expended unnecessarily between network users.

*5. The Energy Union commits the EU to meeting ambitious targets on greenhouse gas emissions, renewable energy and energy efficiency, and also to reducing its dependency on imported fossil fuels and hence exposure to price spikes. Moderating energy demand and fuel-switching to low carbon sources such as renewables, particularly in the heating and cooling sector, can be highly cost-effective solutions to such challenges, and ones that Member States will wish to consider carefully alongside decisions on LNG infrastructure. In this context, do you have any evidence on the most cost-efficient balance between these different options in different areas, including over the long term (i.e. up to 2050)?*

At this moment, we do not have a detailed evidence on the most cost-efficient balance between these options.

## 1.2 Potential entry barriers for LNG

*6. What in your view are the most critical regulatory barriers by Member State to the optimal use of and access to LNG, and what policy options do you see to overcome those barriers? Have you*

*encountered or are you aware of any problems in accessing existing LNG terminal infrastructure, either because of regulatory provisions or as a result of company behaviour? Please describe in detail.*

The Czech Republic would treat potential use of LNG in the same non-discriminatory manner as other energy sources. Based on experience ERO notes that there may be obstacles of various kinds, but not regulatory because ERO has done and will do its best to ensure that the infrastructure associated with direct access to LNG terminals would be realized.
As a form of regulatory barriers may be considered non-existence of methodologies at EU level that would secure the monetization of benefits not only LNG projects, e.g. security aspects of gas supply, reduction of final prices for customers in the region due to increased competition among traders on the gas market.

*7. What do you think are the most critical commercial, including territorial restrictions and financial barriers at national and regional level to the optimal use and access to LNG?*

The basic obstacle is the negative outcome of CBA analysis, on the basis of which none investor decides to implement the project. Investor wants to have fully covered the risks associated with low use of infrastructure and still wants to achieve a high rate of return. In this context, ERO considers it unacceptable that there was a full allocation of costs to the regulated prices, because an increase in regulated tariffs would ultimately lead to a diversion of customers from the gas.
Furthermore, ERO believes that any additional costs included in the price of LNG would mean that the gas would become uncompetitive.

*8. More specifically, do you consider that ongoing EU policy initiatives and/or existing legislation can adequately tackle the outstanding issues, or there is more the EU should do?*

The Czech ERO is of the opinion that the existing legislation and policy measures are insufficient, however, excessive exposure can eventually lead to further distortion of the gas market and to the advantages of LNG over other sources of gas, which is in direct conflict with the ideas of creating an internal energy market while efficiently incurred costs that would be offset by the benefit to the customer.

## 1.3 International LNG markets

*9. How do you see worldwide LNG markets evolving over the next decade and what effects do you expect this to have on EU gas markets? Do you expect a shift away from oil-indexed LNG contracts, and if so under what conditions?*

The MIT and the Czech ERO expect a boom in the development of LNG, followed by saturation of the market and LNG suppliers to these markets. However, it cannot be ignored the main supplier of gas to Europe, Gazprom, which will always be able to offer gas price lower than the price of imported LNG. The result of this interaction will lead to even greater market saturation. Ultimately, this situation could significantly contribute to the recovery of the gas market in the EU.
In this context, ERO considers important to mention that on the one hand there are LNG terminals, but the other side of things is a subsequent supply for these LNG terminals. LNG producers will direct their deliveries to areas with higher selling price, while other subjects will put pressure on minimizing price.

*10. What problems if any do you see with the functioning of the international LNG market, particularly at times of stress? Are there specific actions the EU should take, in dialogue with our international partners, including in trade negotiations, to improve its functioning and/or to make the EU market more attractive as a destination for LNG? Could voluntary demand aggregation be helpful in some way?*

As mentioned above the basic problem is the price of purchased LNG which is at the current price level of traded gas uncompetitive in the wider region of Central Europe including the Czech Republic.

## 1.4 LNG technology issues including LNG in transport

*11. What technological developments do you anticipate over the medium term in the field of LNG and how do you see the market for LNG in transport developing? Is there a need for additional EU action in this area to reduce barriers to uptake, for example on technology or standards, including for quality and safety?*

The MIT and the Czech ERO consider that there is no need for additional measures.

## 1.5 LNG sustainability issues

*12. Do you think there are any sustainability issues specific to LNG that should be explored as part of this strategy? What would be the environmental costs and benefits of alternative solutions to LNG? Please provide evidence in support your views.*

The MIT and the Czech ERO has opinion that the key problem of LNG is its higher price compared to the "classical" gas. It should therefore be the subject to further analysis whether for market exists the corresponding added value to compensate this higher price. ERO deems that based on this added value the market would be willing to accept even higher price of LNG compared to other sources.

# 2 Responses to consultation – Storage

## 2.1 Internal market constraints and challenges for storage

*13. What opportunities or challenges do the supply projections for different sources, in particular LNG and pipeline gas and low carbon indigenous sources, present for the use of gas storage / for gas storage operators?*

We believe that in the context of decarbonisation policies, natural gas will – owing to its smaller CO2, NOx and SOx footprint when compared to oil and coal – play a crucial part in decarbonisation. Natural gas is the only fossil fuel projected to increase its share in the global energy mix in the next two decades, from 21% in 2012 to 24% in 2040 according to the IEA. This is thanks to the expected role of natural gas as a backup of renewables and in spite of the falling demand for gas in recent years resulting from a number of factors including economic slowdown and energy efficiency gains.

As regards LNG and pipeline gas, we see the role of storage facilities as complementary rather than competitive. Gas piped from distant production fields in non-EU countries needs to be stored close to centers of consumption given the seasonal nature of gas demand and in order to ensure security of supply; while LNG offers the possibility of storage, the limited volumes and high costs make this option more suitable for peak shaving and short-term balancing.

*14. Are, in your view, current market and regulatory conditions adequate to ensure that storages can fully play their role in addressing supply disruptions or other unforeseen events (e.g. extreme cold spells)?*

The current conditions on the flexibility market are harming the gas storage business and this could have negative consequences in the long run. Summer-winter spreads, the main indicator used by storage users to value storage capacity, have not recovered from their fall which started around 2010/2011 and remain at between EUR 1 and 2 per MWh, not reflecting the SoS value of storage and far below the operating costs of most European storage operators. Gas price volatility, another variable that can stimulate storage bookings by storage users who wold like to make use of shorter-than-seasonal fluctuations in gas prices, has also decreased significantly from around the same time with only occasional spikes, further denting demand for storage and the prices that storage users are willing

to pay for it. There are no signals that fundamentals will change in the medium term, with suppliers making use of the increased liquidity on the spot markets as their preferred source of flexibility and producers offering more swing in their supply contracts. Coupled with this is the trend in many Member States for storage users to inject less gas into storage before winter than was the case in the past. This, in our view, has a negative impact on security of supply in the event of a supply disruption and in the long run will result in closures/mothballing of facilities (this is already happening in France, Germany and elsewhere) which may be needed in the future.

There are various aspects of the market and regulatory conditions that could be improved to allow gas storage facilities to fully play their role in addressing supply disruptions and other unforeseen events as well as providing seasonal and short-term balancing, helping commercial arbitrage.

Storage competes on the flexibility market with other flexibility tools which often do not face the same regulatory constraints as storage operators, in particular the strict TPA requirements and the difficulty with offering individualized products and services, especially because of restriction regarding trading/sale of gas. .These limitations are a legacy of the 3rd Energy Package adopted at a time when the situation in Europe was completely different.

Market tools should be preferably used to prepare for and deal with supply disruptions and unforeseen events but because national markets vary greatly across the EU (level of domestic production, market liquidity, connectedness to transit pipelines and producing countries, etc.), Member States should be able to also use mixed and non-market measures including storage filling requirements and strategic storage. Any such measures must be non-discriminatory and proportional.

*15. As an alternative to mandatory reserves, how could market based instruments ensure adequate minimum reserves?*

By definition, market-based instruments cannot guarantee a minimum storage filling level because it is up to market players whether and how much storage capacity they book and how much gas they actually inject into storage prior to winter. Their decisions are based purely on market developments including spot prices and forward prices.

However, there are many market-based tools that can incentivize the use of storage, including very high penalties that network users pay for system imbalances during emergencies like in the UK; enabling the TSO to pay for a certain volume of gas to be bought and stored by suppliers to be used in emergencies like in Denmark; or setting transmission tariffs to/from storage facilities low so that suppliers and traders find their use easier and commercially more attractive.

However, given that the individual markets differ greatly in their liquidity, access to flexibility, etc., there must be room for somewhat more prescriptive, but still market-based measures such as the requirement in the Czech Republic for suppliers to protected customers to fulfil a part of their supply standard by storing gas in storage facilities in the EU before winter. Summing up, there is no single perfect solution and Member States should be able to choose from a range of measures those that they deem the best for their particular national or regional situation. Even mandatory reserves can be a useful tool to ensure security of supply provided that they are well tailored to the needs of the local market and used only in predefined circumstances so as not to hinder regular functioning of the market.

## 2.2 Storage infrastructure

*16. Do you have any analysis or view on what an optimal level/share of storage in a Member State or region would be? What kind of initiatives, if any, do you consider necessary in terms of infrastructure development in relation to storage?*

Overall, we believe that the EU has adequate storage capacity with the exception of a few Member States such as those located in SEE.

In general, there are many factors that need to be taken into account when considering an optimal level of storage in a Member State, including:

- Import and single-source dependency,
- Demand ratio between summer and winter,
- Ability to cover seasonal modulation needs and peak demand using other sources of flexibility,
- Structure of gas demand,
- Capacity of connections to other countries,
- SoS concerns, and, last but not least,
- Geological conditions (if these are not right, no storage can be built).

As regards initiatives aimed at boosting storage infrastructure development, a simple measure would be to ensure that sufficient firm transmission capacity to/from storage facilities is available to storage users. As regards financial support from the EU for those Member States with no or limited storage capacity, both TEN-E and CEF should be modified to be better suited for storage projects than their current incarnation, which is heavily skewed towards transmission projects.

*17. Do you think, in addition to the existing TEN-E Regulation, any further EU action is needed in this regard?*

See reply to Question 16 above.

The Czech ERO together with the CEER deem that there is no need for further legislative steps, however, the process of selecting PCI projects in this context should be more effective and efficient.
The Authority also deems that the Commission should avoid a modification of the current legislation towards the advantages of one type over the other projects. This approach would only help to create deformations and barriers on the gas market.

*18. Given uncertainties over future gas demand, how would you assess the risk of stranded assets (and hence unnecessary costs), lock-in effects, the risk of diverting investments from low carbon technologies such as renewables, delaying a transition in energy systems and how would you and weigh those against risks to gas security and resilience? What options exist in your view to reduce the risk of stranded assets?*

First and foremost, the EU must make it absolutely clear that natural gas will be a part of the European energy mix going into the future to assuage any doubts that investors and infrastructure operators may have with respect to the future of their business and the return on their investments into new infrastructure as well as into maintenance and operation of existing infrastructure.

Second, the EU ETS system needs an overhaul so that cleaner technologies such as natural gas can compete against less clean technologies such as coal on an equal footing, with external costs being taken into account.

Third, subsidies for mature renewable technologies should be quickly phased out as they distort the internal energy market.

## 2.3 Regulatory framework and potential barriers for storage

*19. What do you think are the most critical regulatory barriers to the optimal use of storage in a regional setting?*

Assuming that using storage in "a regional setting" refers to utilizing storage capacity across Member State borders, we believe that cross-border flows must be ensured even in emergency situations and that Regulation (EU) No. 994/2010 should be more explicit in saying that. Also, there are real barriers to cross-border flows that should not be overlooked in the form of insufficient firm transmission capacity and/or and lacking reverse flow capabilities at many interconnection points between Member States.

*20. Do you think ongoing initiatives and existing legislation can tackle the remaining outstanding issues or is there more the EU could do? Do initiatives need to include additional issues further to the ones described here?*

It is crucial to ensure the proper implementation of and compliance with existing legislation before launching new initiatives. It is common knowledge that some Member States are yet to fully implement the 3rd Energy Package or Regulation (EU) 994/2010. Often, already available measures are sufficient to tackle new problems and should be used as opposed to constantly changing the regulatory framework which makes compliance ever more costly and difficult.

Having said that, we recognize that some legislation such as the mentioned Regulation, needs updating to reflect practical experience gained in the past few years as well as the opinions of various stakeholders voiced in public consultations organized by the Commission.

*21. Do you consider EU-level rules necessary to define specific tariff regimes for storage only or should such assessment be made rather on a national level in view of available measures able to meet the objective of secure gas supply?*

A specific transmission tariff regime for gas storage facilities is a very good idea if it reflects the unique nature of storage facilities, taking into account that gas storage is not a net source of supply or demand and that users have already paid or will have paid entry/exit tariffs at import/production and at end consumption. As with all transmission tariffs, any specific tariffs applicable to storage facilities must be cost-reflective and TSOs should be required by NRAs to substantiate them in a transparent manner.

*22. Have you ever encountered, or are you aware of, difficulties in accessing storage facilities? Has this concerned off-site or on-site storage facilities? Please describe the nature of the difficulties in detail.*

ERO is not aware of any problems in the access to storage capacities. In this context, the Office together with CEER believe that Third Party Access (or TPA) and transparency are the two basic elements of non-discriminatory access to the storage capacities.

*23. Have you ever encountered, or are you aware of, difficulties related to feeding LNG gas from the storage site back into the gas network? If so please describe the nature of these difficulties (regulatory provisions, company behaviour, technical problems) in detail.*

As stated in our reply to Question 16, storage users are often limited in using storage facilities by the fact that transmission capacity to/from storage is offered only an interruptible basis or in volumes that are below the maximum technical injection/withdrawal capacity of the given storage facility.