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Gas security in Britain and Europe

Politics, policies and the market

Pierre Noël

EPRG, University of Cambridge

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E·S·R·C ECONOMIC & SOCIAL RESEARCH COUNCIL

Main messages

- UK politicians are losing faith in gas market -- despite GB enjoying a high level of supply security
- Europe has a real political problem with Russian gas, which can only be addressed by building a market
- After 15 years of slow-motion, European reforms might be gathering pace, hugely helped by the gas glut
- Gazprom's business model is under stress and might collapse – rising liquidity leads to spot indexation, which boosts liquidity
- Not the right time for the UK to emulate the Continent!

1. The British Confusion about Gas

- Gas is now perceived by all parties as an “insecure” form of energy – Rising import dependence; Russia dominance
- More government intervention (in gas market and fuel-mix) is said to be needed
- However, Great Britain enjoys a high level of gas security – and owes it to its policies
  - Well developed import infrastructure
  - Market arrangements cope well with tight situations
- Even if there were more Russian gas coming to the UK, that would not compromise security

Confused British (elite) newspapers

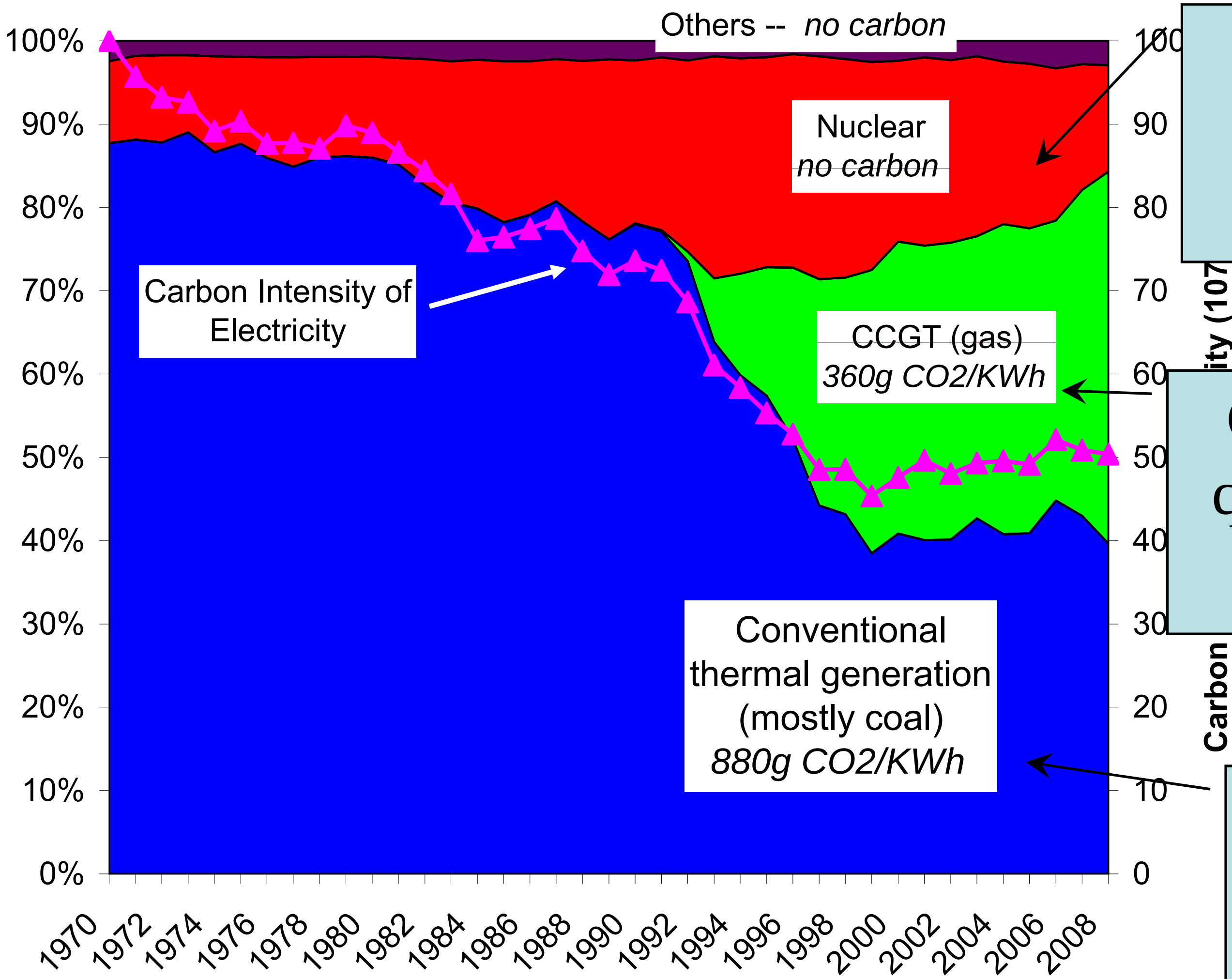
- Nuclear + LCPD retirement
- Renewables cost and intermittency
- CCS cost and uncertainty
- 9 GW of CCGTs being built
- But the new 'dash for gas' should be stopped because dependence on Russia is dangerous

Confused UK politicians -- *The Wicks report*

- "During my visit to Norway during this review, I was told repeatedly that the UK's open and transparent market, including the ease with which gas could be exported from the UK to continental Europe, was a fundamental reason why Norwegian suppliers are keen to send their gas our way. […] Our regulatory structures need to be stable to enable partners to make strategic commitments to the UK market". – *Wicks Report, pp. 97-98.*
- "It could increase the UK's gas security if there was a requirement that a proportion of the stored commercial gas could be released only to meet supply requirements in the UK." *Wicks Report, pp.116-117*

Conservatives (Ch Hendry) make similar proposals – Ban on 'exports'; strategic storage; public service obligations…

UK: Gas is key to lower-carbon electricity



New nuclear is for 2020+ (if we get the carbon price right)

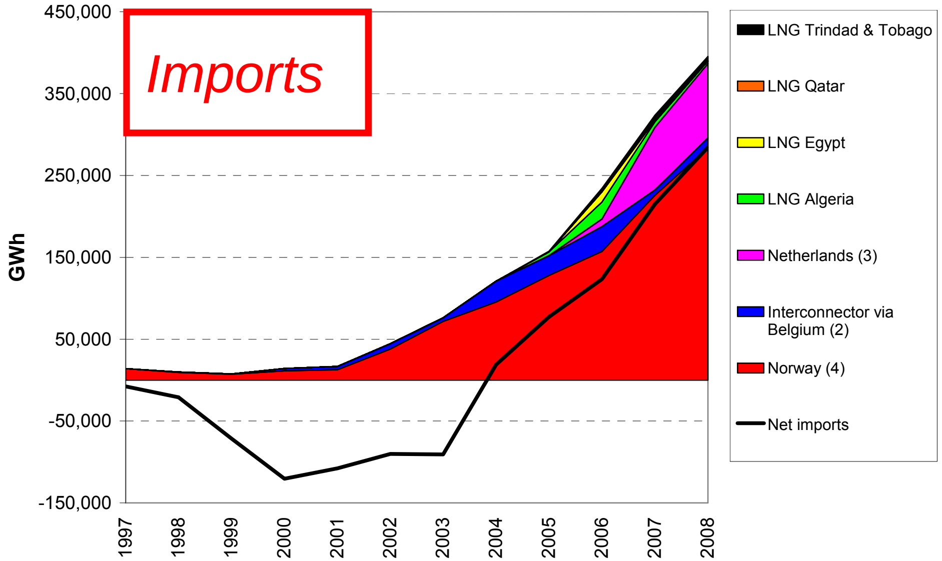
CCGTs can be built quickly, with low (or no) carbon price

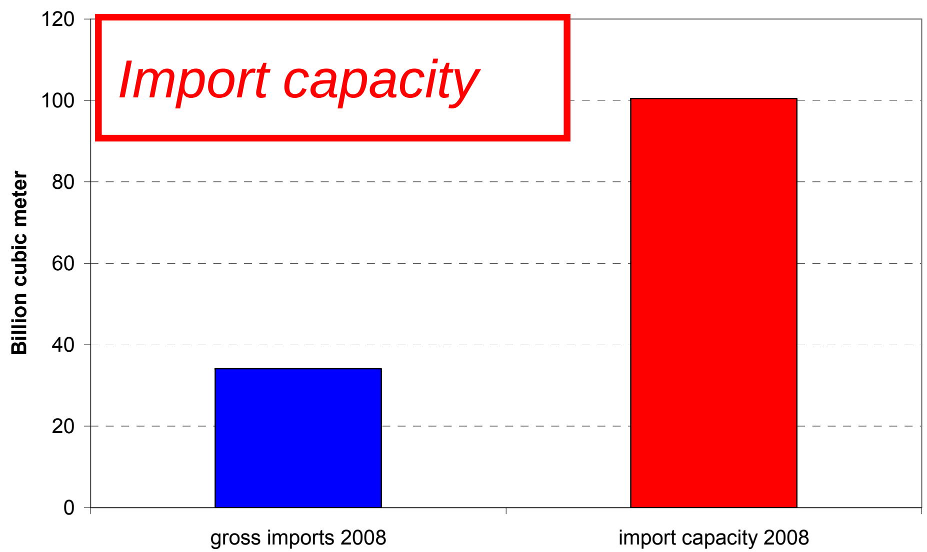
CCS is for 2020+ (if we get the carbon price right)

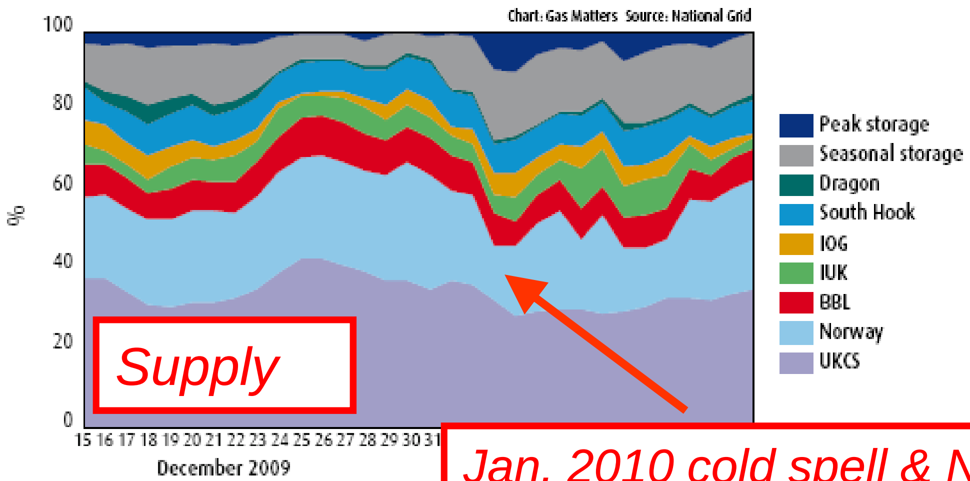
Data source: DECC

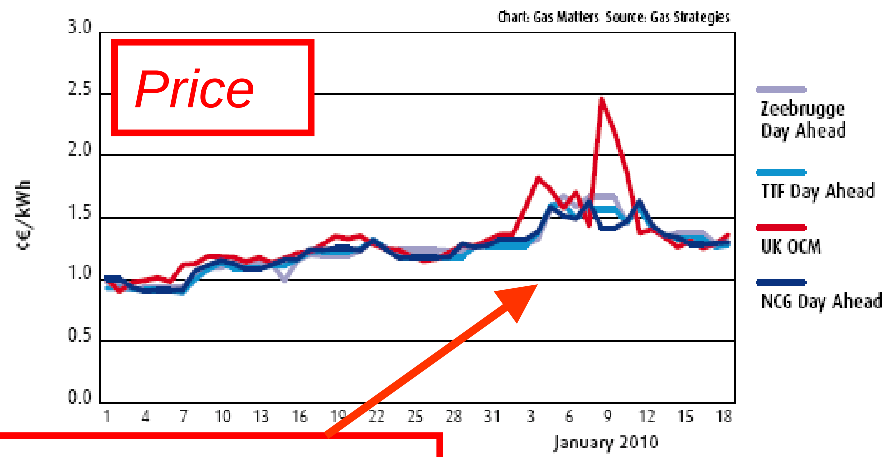
The GB market delivers security

Data source: DECC









Jan. 2010 cold spell & Norwegian outage
(2 charts from Gas Matters, February 2010)

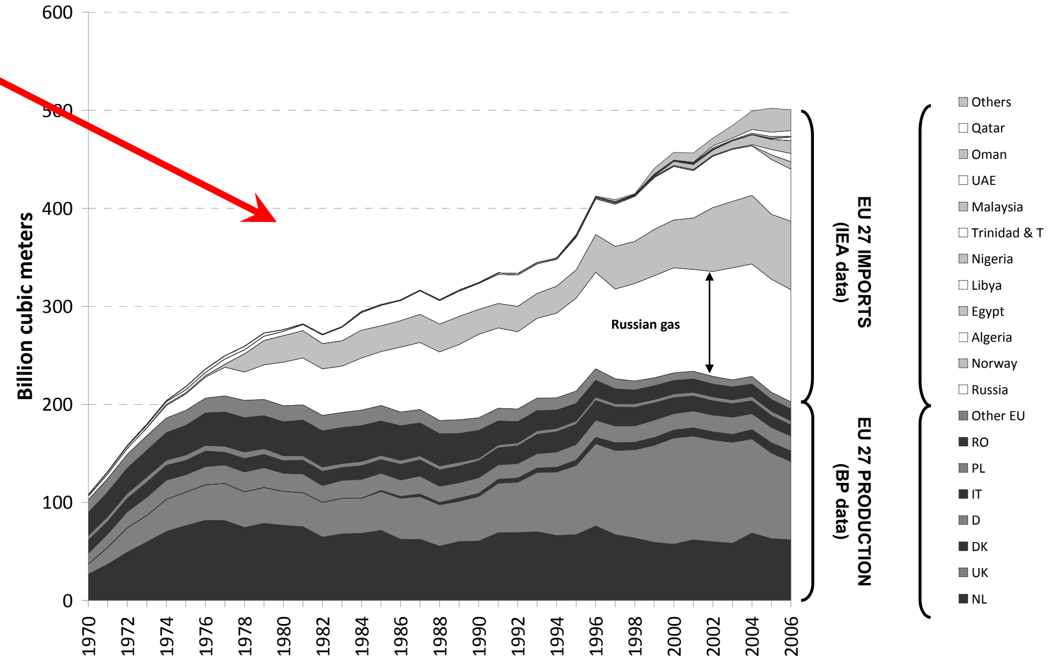
2. The European Problem with Russian Gas

- To manage its ‘dependence’ problem Europe needs a competitive, integrated wholesale market
- Gas security is a key political issue in the post-enlargement EU
- After 15 years of policy efforts (driven by the UK!), the outcome has remained elusive
- Unholy alliance between incumbent gas companies and pro-Russian governments – and other issues as well

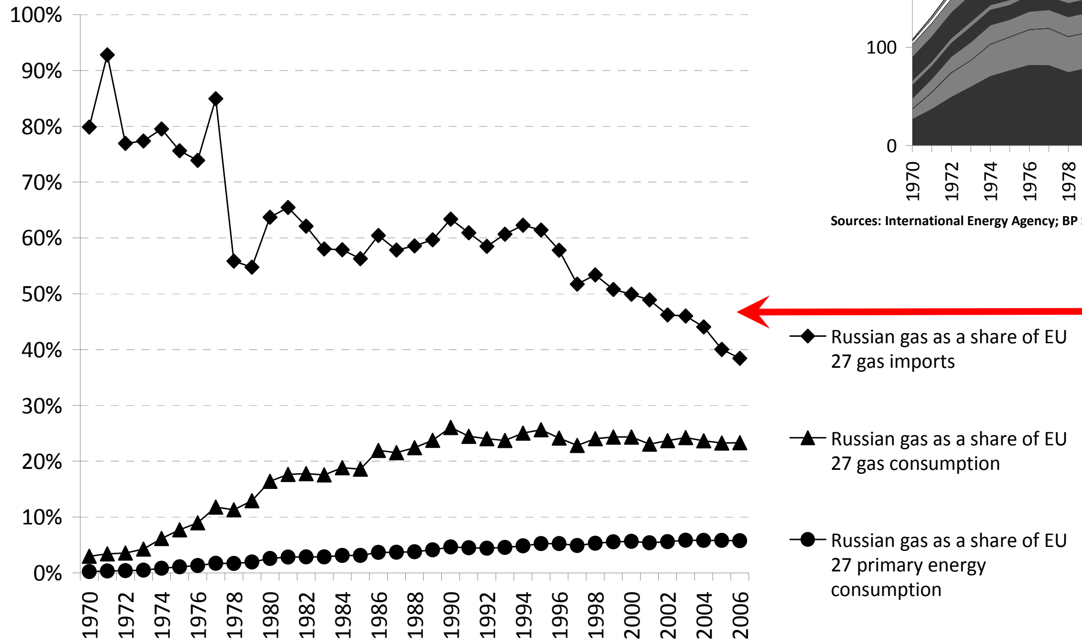
Rising imports, falling dependence

IMPORTS UP

Since 1990, EU imports rose from 43% of consumption to 60%



Sources: International Energy Agency; BP Statistical Review of World Energy



Source: BP Statistical Review of World Energy; International Energy Agency

DEPENDENCE DOWN

Since 1990, Russian gas went from 65% of EU imports to 39% (28% of consumption to 23%)

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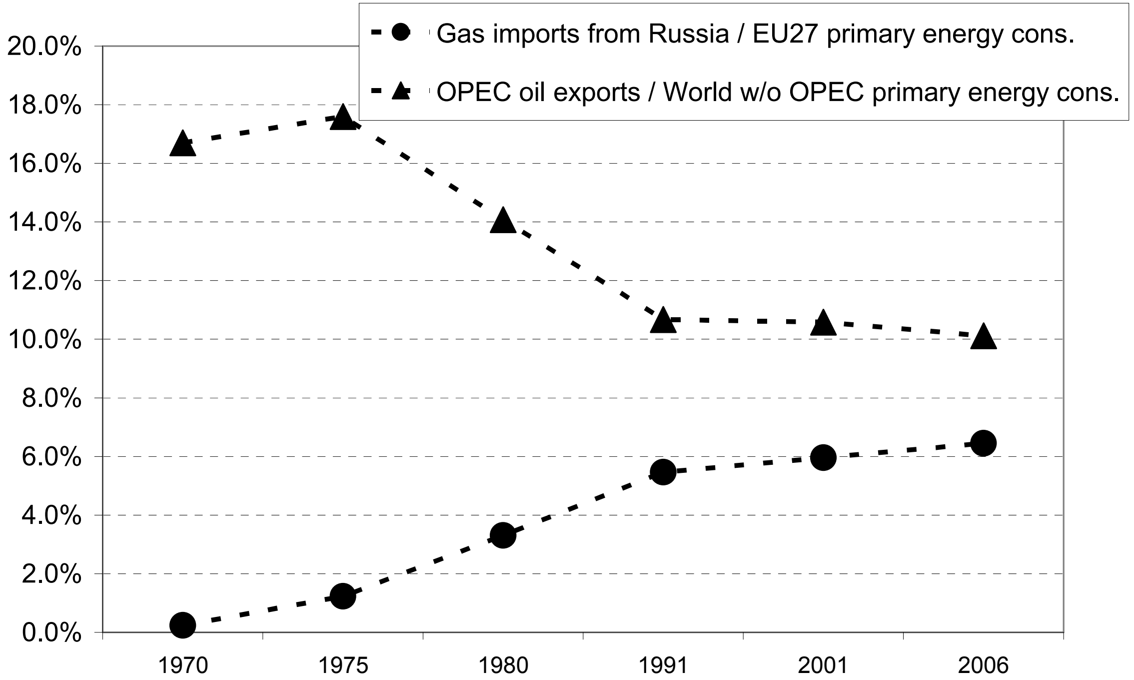
Europe's dependence in perspective



Sources: Gazprom; BP Statistical Review of World Energy

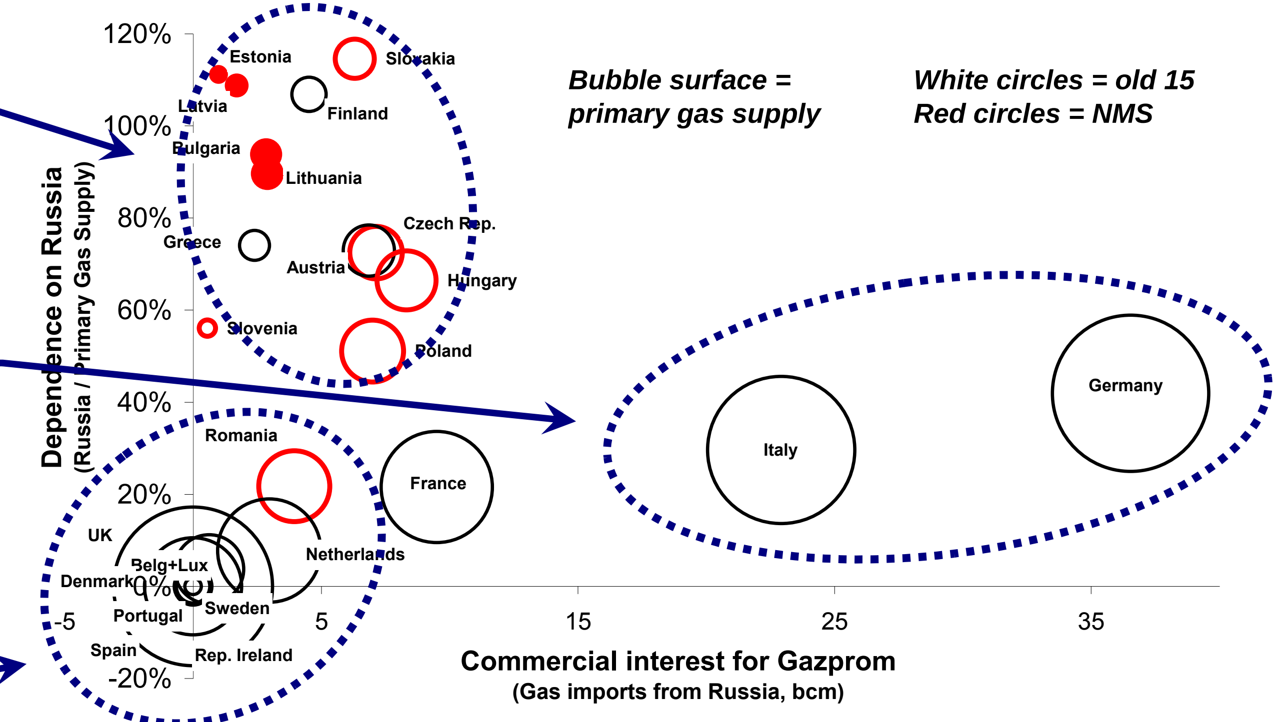
The way markets work has a big impact on the political implications of 'import dependence'

The three Europes of Russian gas

Central & Eastern Europe – Limited volumes from Russia but high dependence

Italy + Germany = almost 50% of all contracted Russian gas in the EU

Most of Western Europe has limited and declining dependence on Russia



Source: BP Statistical Review; Eurostat

A single competitive gas market would have huge benefits -- move diversity eastward, make Europe more attractive for LNG and increase the system's resilience to external shocks

Pro-Russian governments opposed ownership unbundling

ECFR EU-Russia Power Audit

Foreign policy attitude towards Russia (ECFR)	Oppose 'ownership unbundling'	Support 'ownership unbundling'
Trojan horses		
Cyprus	•	
Greece	•	
Strategic partners		
France	• **(leader)**	
Germany	• **(leader)**	
Italy		
Spain		•
Friendly pragmatists		
Austria	•	
Belgium		•
Bulgaria	•	
Finland		•
Hungary		
Luxembourg	•	
Malta		
Portugal		
Slovakia	•	
Slovenia		•
Frosty pragmatists		
Czech Republic		
Denmark		•
Estonia		
Ireland		
Latvia	•	
Netherlands		• **(leader)**
Romania		•
Sweden		• **(leader)**
United Kingdom		• **(leader)**
New cold warriors		
Lithuania		
Poland		

Source: Categorising of EU countries according to their foreign policy towards Russia, from: Mark Leonard and Nicu Popescu, *A Power Audit of EU-Russia Relations* , London: European Council on Foreign Relations, 2007, p. 26-50. Position towards ownership unbundling of gas transmission from supply activities, from: Letter from the Ministers in charge of energy of eight EU member states to Angelika Niebler, Chairwoman of the ITRE Committee, European Parliament, dated 29 January 2008; "'Third Option' mooted on energy liberalisation", Euractiv.com, 27 November 2007.

Izvestia "Русский вопрос" расколол Европу" (2 Sept 2008)

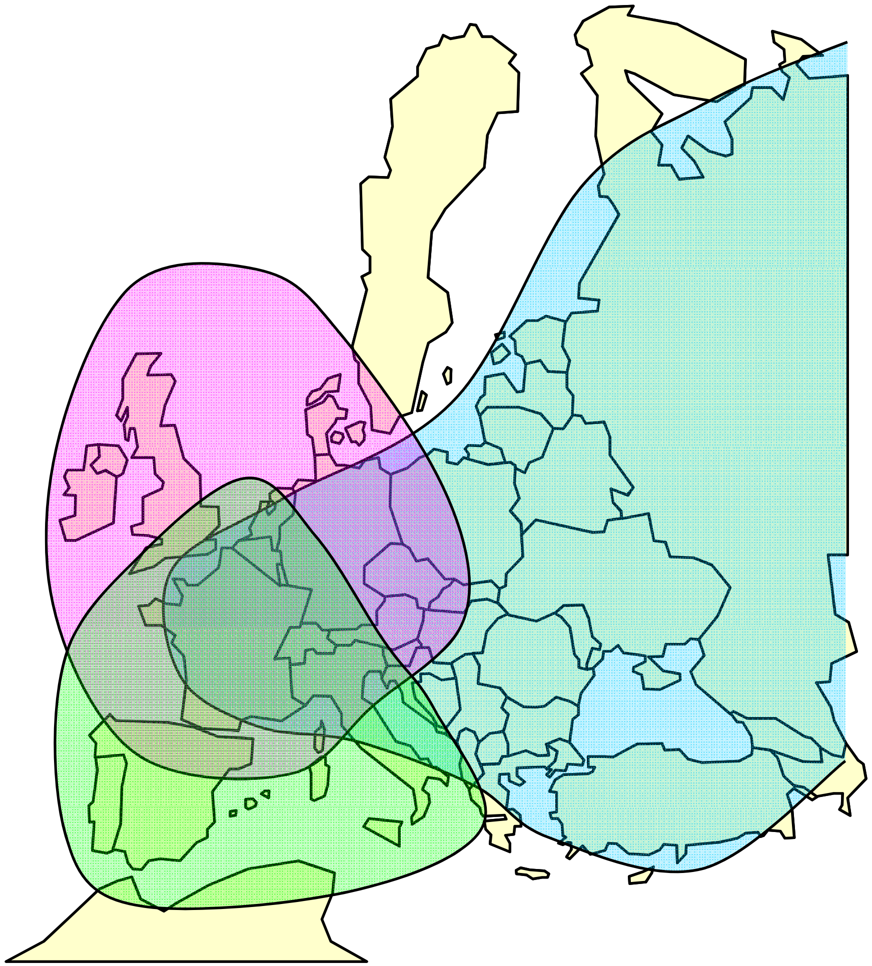
Foreign policy attitude towards Russia (Izvestia)	Oppose 'ownership unbundling'	Support 'ownership unbundling'
Russophobes		
Poland		
Lithuania		
Latvia	•	
Estonia		
UK		• **(leader)**
Sweden		• **(leader)**
Moderate Critics		
Czech Republic		
Hungary		
Romania		•
Denmark		•
Pragmatics, Centrists, Neutrals		
Slovakia	•	
Slovenia		•
Bulgaria	•	
Spain		•
Finland		•
Netherlands		• **(leader)**
Austria	•	
Ireland		
Portugal		
Malta		
Russia's Lobbyists		
France	• **(leader)**	
Germany	• **(leader)**	
Italy		
Belgium		•
Luxemburg	•	
Greece	•	
Cyprus	•	

Source: Categorising of EU countries according to their foreign policy towards Russia, from: Izvestia, "Русский вопрос" расколол Европу ("Russkii vopros" raskalol Evropu), http://www.izvestia.ru/politic/article3120068/ (2 Sept 2008). Position towards ownership unbundling of gas transmission from supply activities, from: Letter from the Ministers in charge of energy of eight EU member states to Angelika Niebler, Chairwoman of the ITRE Committee, European Parliament, dated 29 January 2008; "'Third Option' mooted on energy liberalisation", Euractiv.com, 27 November 2007.

3. EU Recent Policy Response

- 3rd liberalisation package
  - More TSO independence – but short of ownership separation
- DG Competition's big push on energy
  - Sector Enquiry (2005-2006)
  - Cases against E.On (elec); RWE (gas); ENI (gas); E.On (gas); GdF (gas) – meaningful remedies obtained
- Regulators' Regional Initiatives
  - Practical work on barriers to trading and market integration
- National Regulators' work in key markets (FR; DE; BE; AT; IT…) – more independent; more competent; more aggressive

Integrating Europe



Map adapted from Gas Natural

France, Belg., Ger., AT, are key to:

- **Competition between ‘North-western gas’, ‘south-western gas’, and Russian gas**
- **‘Europeanising LNG’**
- **Central Europe’s access to non-Russian gas**

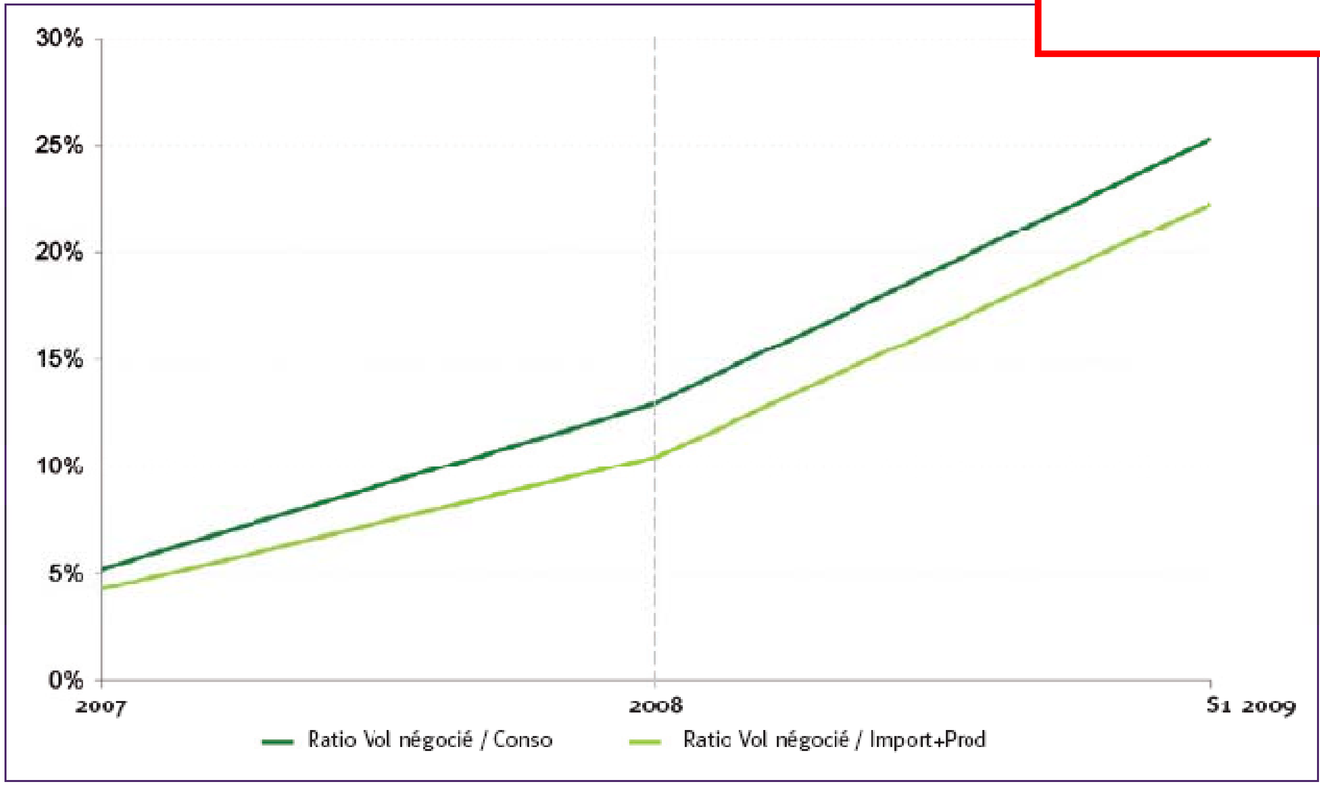
Progress real, if slow

- **Increased interconnection**
- **Merging of trading zones**
- **Reform of balancing regimes**

Rising liquidity: France

Graph from Commission de Regulation de l'Energie (French regulator)

Traded gas on the French market: from 5% in 2007 to 25% in 2009



Sources : Brokers, Powernext, GRTgaz, TIGF – Analyse : CRE

4. Recent market & industry developments

- Europe is awash in non-Russian gas, a lot of it priced on the spot market – much cheaper than oil-indexed gas
- LNG supply boom; global recession; North American supply revival
- Is Gazprom's business model collapsing?
  - 'We will not re-negotiate' (December 2009)
  - All large LT contracts re-negotiated (at least 15% spot indexation) (Febrary 2010) – only for "crisis period"
  - Temporary glut or structural change? In oil, a 'temporary' glut did trigger a structural change in early 1980s
  - OPEC was also in denial about the collapse of the traditional contracts…
  - The key to a lasting structural change is market liquidity – which will be boosted by the renegotiations

Conclusions

- The British confidence crisis in gas markets is not only unwarranted, but also very badly timed
- The gas glut and recent policy developments (EU and national) are boosting liquidity in continental European markets; integration is progressing
- Gazprom's business model is tested
- The interest of large European gas companies is changing – diversified supply and client portfolio, across EU – *they value a pan-European wholesale market*
- The British long-term investment in EU gas liberalisation may be about to pay – No time to back-pedal!