

# Gas Interconnectors in Europe: More than a Funding Issue

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9 April 2009

Gas interconnectors<sup>1</sup> play a pivotal role in opening up the European gas markets to competition and so to create a single market for natural gas in which consumers are free to choose their own supplier. Moreover, in linking different gas transmission systems throughout Europe, interconnectors increase the flexibility of the gas network benefiting Europe's security of supply.

In the EU, there are over 60 connection points allowing natural gas to enter and exit across different member states.<sup>2</sup> However, interconnectors are not always located where – from a security of supply point of view – they are most needed. In particular, Eastern European countries, the Baltic region and, to a minor extent, the Iberian Peninsula remain at the periphery of the European transmission system often relying on importing pipelines for their integration into the European gas market. Accordingly, the completion of the internal market for gas is still far from being a reality. In addition, in case of unexpected supply disruptions, the security of supply potential of gas interconnectors can rarely be exploited since few of them can be reversed (e.g. those linking transmission systems of the UK and Belgium, the Netherlands and Germany and Belgium and Germany). To improve the status of the European gas network, the Commission has supported – in the framework of the Trans-European Energy Network (TEN-E) projects – the development of a number of cross-border interconnections some of which have been classified as “projects of European interest” (e.g. the Baltic gas interconnector and the Greece-Italy interconnection pipeline). However, the implementation of gas interconnections between member states has so far progressed at low pace and only few of the needed infrastructures have been built since the start of the TEN-E.<sup>3</sup>

It is sometimes argued that the main obstacle for building new gas interconnections is related to their scarce investment profitability. The idea is that network operators profit from the *status quo* of the European gas market, where unbundling remains limited and supply concentration as well as high price and profit differentials persist. In linking gas transmission systems, interconnectors make the market more homogeneous and liquid, reducing profit spreads. The economic incentives of network operators to build new interconnections are thus limited, especially in a context where there are provisions to open new infrastructure to competitors

<sup>1</sup> According to Art. 2 of Directive 2003/55/EC, a gas interconnector is “a transmission line which crosses or spans a border between Member States for the sole purpose of connecting the national transmission systems of these Member States”.

<sup>2</sup> *GTE+ European Capacity Development Report 2008*, Gas Infrastructures Europe, 28 November 2008, Brussels.

<sup>3</sup> *TEN-E financed projects 1995-2007*, European Commission, 6 October 2008, Brussels.

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(Directive 2003/55/EC, art. 18) and exemptions are subject to tight conditions (art. 22) decided on a case-by-case basis. Although true, this is only half of the story. As a matter of fact, network operators also face – at the EU level – a fragmented and uncertain regulatory environment which they judge inadequate for risky and capital-intensive investment. To a lesser extent, difficulties in financing, time-consuming administrative procedures and high opportunity costs have sometimes been responsible for postponement or cancellation of planned projects.<sup>4</sup>

In the case of gas interconnectors, the EU clearly faces a market failure for which – from a security of supply point of view – public intervention is essential. The EU has two options to provide the needed public good: it could finance the missing interconnections that are not profitable for network operators or provide a regulatory system across Europe to motivate private investments. Given the importance of this infrastructure for both the completion of the internal market and the security of gas supply, the European Commission should in fact consider adopting both strategies.

A stronger EU co-financing commitment in favour of gas interconnectors is apparently difficult since the total TEN-E budget for the period 2007-13 amounts to €155 million, including electricity projects and gas-importing pipelines.<sup>5</sup> However, the Commission's stimulus plan to reallocate €5 billion of unspent 2008 EU agricultural funding could provide an additional opportunity for financing missing gas interconnections. The last proposal of the plan (20 March 2009) goes in this direction: €1,440 million have been allocated for gas interconnectors, including €150 million for the Baltic area, €290 million for Central and South East Europe interconnections, €365 million to reinforce the Mediterranean connections and €235 million for the North Sea area.<sup>6</sup> The Commission should continue to work on this front making sure that the Council and the Parliament will finally allocate these funds for gas interconnectors. However, the injection of funds alone would not be able to warrant the future use of gas infrastructure nor the provision of future needed investments. Creating a stable and harmonised regulatory framework is indeed an essential step to provide a sustainable solution to the existing market failure. To this end, two sets of policy provisions are highly needed.

First, the Commission should make sure that European gas infrastructure is evaluated by a single regulatory body reducing bureaucracy, fragmentation and regulatory risk. The proposed Agency for the Cooperation of Energy Regulators (ACER)<sup>7</sup> -- an independent entity in charge of providing a framework for cooperation among national regulators -- is a first step in this direction but could hardly be the solution. In order to create a harmonised, stable and transparent regulatory system across the EU, a simple cooperative framework between national regulators may not be sufficient. On this regard, the limited achievements of the European Regulators Group for telecommunications should be kept in mind. The European Commission should therefore propose effective power for the ACER so to ensure stable and uniform regulation; otherwise, this body risks turning into a 'government failure' which could lead to a conflict of competencies among various regulators and hence to more inefficiency. Yet, as a result of the Maroni doctrine,<sup>8</sup> an independent ACER may need a revision of the EU Treaties. Integrating the ACER into the European Commission as part of competition policy authority may instead be the best option. An additional strategy to encourage investment could be to

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<sup>4</sup> *GTE Investment Report*, Gas Infrastructure Europe, 8 January 2006, Brussels.

<sup>5</sup> *Green Paper, Towards a Secure, Sustainable and Competitive European Energy Network*, European Commission, 12 November, 2008, Brussels.

<sup>6</sup> *Presidency compromise proposal for financing of infrastructure projects put forward by the Commission as part of EERP*, Council of the European Union, 7948/1/09 REV1, 20 March 2009, Brussels.

<sup>7</sup> *Proposal for a Regulation of the European Parliament and of the Council establishing an Agency for the Cooperation of Energy Regulators*, European Commission, 2007, Brussels.

<sup>8</sup> The Meroni doctrine goes back to a 1958 European Court of Justice judgment that has been applied ever since. According to it, delegation of powers to independent agencies must be limited to implementing powers clearly defined and entirely supervised by the delegating institution on the basis of specific and objective criteria. This means that delegation cannot concern discretionary powers involving a margin of political judgment.

increase access prices to gas interconnectors by a risk premium. Although access prices are usually regulated at national level, if the ACER is given effective power, it could also take care of setting the risk premium.

Second, the European Commission should clarify and, in some cases, even update definitions and rules of the existing European gas regulation. Art. 18 of Directive 2003/55/EC, regulating third party access to transmission systems, does not provide incentives to operators to build new interconnections because, once in place, they have to be opened to competitors. Yet this provision is crucial for the liberalisation of the gas market and is unlikely to be removed. Greater attention should instead be dedicated to Art. 22 of the same Directive, which allows for exemptions from Art. 18. The conditions for exemption are tight (only three exemptions have been allowed so far: BBL, Poseidon and the Austrian section of Nabucco) and the procedures to obtain it are time-consuming and highly bureaucratic. The Commission should therefore introduce greater flexibility in Art. 22 and strengthen its incentive function for investments. Furthermore, the Commission should encourage the Parliament and the Council to continue to review the definition of gas interconnectors, as it appears in Directive 2003/55/EC. In particular, the distinction between gas interconnectors, import pipelines and import pipelines which play the role of interconnections should be clarified to prevent confusion and ambiguities in the application of the European regulation. Finally, the new definition should include the concept of reversible gas flow, if not by making it mandatory for new gas interconnections, at least by encouraging its adoption where economically reasonable.