Gas Transmission Operator GAZ-SYSTEM S.A.'s response to the public consultation on EIB's Energy Lending Policy

Dear Sir,

The European Investment Bank (EIB) has decided to ask stakeholders representing different sectors for their views on how its Energy Sector Lending Policy shall be reviewed so that the Policy responds adequately to changing conditions on global and EU energy markets.

We would like to thank the EIB for this possibility to express our views and concerns about this important topic as the financial assistance offered by the EIB is an important catalyst that significantly streamlines implementation of investment projects in the gas sector. We hope that the consultation process, and stakeholder's input gathered therein, will contribute to enhancement of investment conditions for project promoters in the European Union.

Gas Transmission Operator GAZ-SYSTEM S.A. (GAZ-SYSTEM hereafter) is a strategic company for the Polish economy, responsible for the transport of gas via the transmission network throughout the country to supply with gas the distribution networks and final customers connected to the transmission system. GAZ-SYSTEM is currently in the process of implementing a large investment program aimed at developing internal transmission network and enhancing its interconnectivity with adjacent systems (approx. 1000 km pipelines to be commissioned by 2014). The company is also responsible via its SPV (Polskie LNG S.A.) for the construction of the LNG terminal in Świnoujście.

Please find below GAZ-SYSTEM's responses to the relevant questions that are linked with the natural gas market and natural gas infrastructure in particular.

We remain at your disposal for further questions and clarifications.

Rafał Wittmann
Director of Development Division
General energy and economic questions

Particularly in the current economic climate, is there a trade-off between promoting a competitive and secure energy supply and one which is environmentally sustainable? Where should the balance lie and what implications does this have for energy sector investments?

As underlined by the EIB, European energy policy aims at transforming the energy markets in the EU member states so that they fulfill all three overarching goals related to sustainability, competition and security of supply. In current circumstances, the balance between these pillars seems to be, however, disturbed as the greatest attention is given to sustainability and renewable energy sources in particular. This approach raises a number of risks and challenges associated primarily to the proper functioning of the energy market (growing difficulties to effectively balance the energy system that is more and more dependent on intermittently renewables as for instance it is the case of Germany and its Energiewende) and those of financial nature (high costs of renewable energy especially in the current period of economic turmoil).

Having this in mind, we would like to suggest that the EIB’s Energy Lending Policy supports the UE’s objectives by assisting projects that contribute simultaneously to a sustainable, competitive and secure energy market in the UE. This approach will ensure that energy markets in Europe are developed in a well-balanced and cost-effective manner, while taking into account the conditions for the safe functioning of the gas and electricity transmission systems and bringing the most benefits to energy consumers.

Investments in natural gas infrastructure do meet the precondition specified above as natural gas is the most environmentally-friendly fossil fuel that paves the way for the most efficient and competitive transition into a low-carbon energy system in Europe. This is especially the case of Poland and other EU member states that largely depended on coal and lignite in terms of energy production. Similar attitude can be also applied across Europe with regard to transport sector, especially in case of the maritime transport, since the EU policy advocates reduction of greenhouse gases emitted by ships (ships to be fuelled on LNG instead of more detrimental heavy oil). These two examples illustrate that a wider use of natural gas in Europe meets environmental objectives set by the EU.

Furthermore, implementation of natural gas infrastructure enhances security of supply and advances competition by increasing interconnectivity between energy markets and providing adequate technical conditions for uninterrupted flow of gas in normal and emergency situations. This in turn enables to import natural gas supplies from multiple sources (pipeline gas and LNG), allows the entry of new competitors, results in more competitive prices for gas consumers, thus protecting the EU competitiveness with respect to other major global players.

How does investment in the energy sector contribute to growth and employment? Are investments in all energy sub-sectors equally valuable? And how does investment in the energy sector rank relative to other investments in the economy which support growth and employment?

The energy industry contributes to economic growth in two ways. First, energy is an important sector of the European economy that creates jobs and value by extracting, transforming and distributing energy goods and services throughout the economy. The energy industry extends its reach into economies as an investor, employer and purchaser of goods and services.

Second, energy underpins the rest of the economy. Energy is an input for nearly all goods and services. In many countries, the flow of energy is usually taken for granted. But price shocks and supply disruption can shake whole economies.

Recent research demonstrates that the energy industry supports many more jobs than it generates directly, owing to its long supply chains and spending by employees and suppliers. In addition, new infrastructure provides for more competitive energy sources (diversification, source competition) which translate into whole economies’ competitiveness (with the special interest of industry).
What impact do you consider the current economic crisis will have on the energy sector (demand, policies, supply)?

The current economic circumstances has had an impact on the demand for gas in some EU member states but requirements for natural gas infrastructure in Europe are expected to grow in the future. First of all, this will be the result of forecasted growth of demand. According to the analysis conducted by Booz&Co.¹, the demand on the European level will increase from 502 bcm/y in 2012 up to 602 bcm/y in 2030. During this timeframe, the demand in Poland is expected to increase by approx. 93%, so from current 14.5 bcm/y up to approx. 28 bcm/y in 2030, mostly due to a wider use gas in power generation (at present more than 90% of electricity is produced from coal and lignite in Poland, natural gas is responsible for only 2-3%). Secondly, development of intermittent renewable energy production will have similar effect on requirements for natural gas infrastructure, primary on peak capacity to cover unfulfilled demand at unfavorable weather conditions.

Security of Supply

Is the traditional model for electricity transmission and distribution changing? What implications does this have for future investments in electricity networks?

We would like to draw the attention of the EIB that security of supply issues are relevant not only for electricity grids, but also for gas networks. This is especially the case due to the need to further develop internal transmission networks and cross-border interconnections in Central-Eastern Europe (CEE) and the Baltic Sea region. These countries are largely dependent on gas supplies from the Eastern direction. In addition, the lack of sufficient interconnections linking the CEE and Baltic countries themselves and with well-developed markets in Western Europe makes it impossible to use fully the European spot market under normal situations and in the event of disruption or severe weather conditions.

First positive developments in this area took place since supplies were disrupted via Ukraine in 2006, 2009 and via Belarus in 2010. This is to a large extent the impact of the EU energy policy, including European Regional Development Fund, European Energy Programme for Recovery and III Energy Package, and the EIB’s financial support that streamlined investment process in Poland and other EU member states. Nevertheless, the experience of “the cold spell” in February 2012 clearly shows that further and more intense actions are needed towards a truly integrated and secure gas market in the whole EU.

Fossil fuel

Gas is an important bridging fuel source in the transition to a low carbon economy: to what extent and under what conditions should gas-fired generation be supported?

Natural gas should not be labeled as a bridging fuel only. We wish to emphasize that its role in the EU’s energy mix may well extend beyond 2030 and remain significant also in 2050. On a global scale, positive developments in the upstream area (production of gas at new conventional and unconventional fields in multiple countries in the world) accompanied by positive forecasts of the International Energy Agency make natural gas more abundant and affordable, thus constituting a sound basis that underpins its role in the long run.

This potential should also be utilized in the EU given favorable carbon footprint of natural gas (emissions two times lower than in case of other fossil fuels), well-developed infrastructure in Western Europe and actions taken currently to reach the same level in other EU member states. Having this in mind, gas-fired power generation should be supported not only as a back-up solution to cover unfulfilled demand but also as a primary source of energy. The recent example of the US clearly indicates that natural gas constitutes a competitive source of energy that brings at the same time many environmental benefits to the society.

¹ The consultant working for the European Commission within the Energy Infrastructure Package.
What is the scope for the development of shale gas resources in the EU?

Indigenous production of natural gas in the EU may increase significantly due to unconventional gas (including shale gas). According to information available to GAZ-SYSTEM, the potential for unconventional gas development in the EU is large, especially in Poland. The first volumes of unconventional gas may be produced in the EU around 2015-2020.

Do you expect the share of natural gas in EU primary energy consumption to grow further?

Please refer to the previous question on the impact of the current economic crisis on the energy sector on page 3.

What would be the best approach to increase security of gas supply and reduce import dependency?

The degree of market development and natural gas transmission system varies considerably within Europe. There are countries with mature markets, well developed transmission systems, equipped with a diversified portfolio of supplies, and a liquid trading hub. Conversely there are countries with underdeveloped transmission systems which are dependent on a single source of supply, lacking the interconnectivity with their neighbouring states and gas markets. This results in range of barriers in transmission of gas across the different European countries.

Therefore, in order to increase security of gas supply and reduce import dependency, it is essential to promote and support financially those projects that remove existing market imperfections either by linking transmission systems that are currently not connected or the capacity of existing interconnections is not sufficient to cover growing demand for cross-border services or by upgrading internal networks to eliminate existing bottlenecks. This approach would ensure that gas infrastructure in all EU member states, especially in the CEE and Baltic Sea regions, is well-interconnected and sufficiently resilient to emergency situations (disruptions and severe weather conditions).

It should also be borne in mind, particularly in the context of ensuring security and diversification of supplies, that projects based solely on funding by the market will not be able to fully protect these objectives. This follows from the fact that the market (shippers) contracts the projects based on defined and specific customer expectations, and will not fund the additional capacity needed to ensure security of supply in the case of the exclusion of one of the sources of supply. In addition, it should be noted that the market-based infrastructure projects are always looking for the cheapest option which usually are not, at least in the short and medium term, options to diversity.

Given the large uncertainty on future gas demand, what is the risk that investment in natural gas infrastructure may be stranded?

Transition towards a low-carbon economy implies that the risk of stranded assets in gas infrastructure is assessed. Such possibility could occur if the amounts of gas to be transported, stored or regasified are reduced considerably over the next decades. However, as specified above, natural gas meets the objectives of the EU energy policy related to sustainability, competition and security of supply that underpin the role of natural gas in the EU’s energy mix in the long-term perspective. In addition, market-based mechanisms applied by gas infrastructure operators to determine demand for new and incremental capacity, in conjunction with stable and attractive regulatory environment, further diminishes the risk of stranded assets in gas infrastructure.