



Shell Energy Europe

# EXISTING TRANSPARENCY REQUIREMENTS FOR NATURAL GAS

Response of Shell to ERGEG's Public Consultation

## CONTENTS

Opening Letter to ERGEG from Shell	3 – 5
Shell Answers to the Questions for Stakeholders	6 – 10
Appendix – About Shell	11



## Shell Energy Europe

80 Strand  
London  
WC2R 0ZA  
United Kingdom  
Tel : +44 207 546 3146  
Email : [matthew.allan@shell.com](mailto:matthew.allan@shell.com)

European Regulators Group for Electricity & Gas  
Council of European Energy Regulators  
28 rue le Titien  
1000 Bruxelles

26th November 2010

Dear Mrs Geitona,

### Existing Transparency Requirements for Natural Gas

Shell welcomes the opportunity to respond to ERGEG's consultation on existing transparency requirements for natural gas. We are very conscious of the vital importance of maintaining progress towards the overall aim of facilitating the creation of a single, competitive, efficient and sustainable internal market for gas in Europe.

Shell strongly supports the ongoing implementation of the EU Third Energy Package and, specifically with regard to transparency, the provisions of Regulation 715/2009.

We have given careful consideration to proposals for developing regulations around transparency but stop short of supporting full disclosure of certain confidential information because we recognise the enormous difficulties and consequences that may arise.

We realise this is not a unanimously held view and welcome the opportunity for engagement with policymakers and stakeholders. Indeed, we hope better debate will shine a light on to why further measures, beyond the Third package and 715/2009, are being so strongly championed by certain market participants ahead of other issues more critical to the development of energy markets across Europe. Given the success of the UK market where is the motivation, beyond commercial benefit for traders, for further regulation ?

The purpose of our response is to pinpoint where the line of fair and sensible transparency is, that can also be readily enforceable in proportionate and targeted regulation.

For we have given significant thought to what purpose gas transparency serves, to whom, and for what. In this light our comments are set against the main duties of policy makers to ensure a secure supply of affordable, low carbon energy delivered through a competitive market for the ultimate benefit of consumers.

### Proportionate, Targeted and Transparent Regulation

There now exists, in both the Third Package and 715/2009, significant regulation creating a new benchmark in information sharing across the EU market. But they have not yet been fully implemented or enforced. It is premature to shift focus on to further regulatory measures. We believe regulators would best serve market interests by delivering full pan-European implementation, enforcement and evaluation of existing measures.

National Grid Gas introduced the measures in 2006 helping the UK become the premier trading hub in Europe. Consequently Shell has no difficulty in pinpointing the line of fair and sensible transparency at this point in time because it has already been drawn.

## Is Further Information Disclosure Required ?

The starting point of this debate was the EU 2006 Energy Sector Inquiry, though the findings directed a sharp focus towards vertical integration and a lack of transparency in electricity. A natural consequence of this has been diversionary advocacy and / or a one size fits all, general approach to policy and market regulation.

Of course it is quite easy to talk in generalities; but much more difficult to translate into practical proposals that will establish a framework of better regulation. Some advocate immediate publication of information on gas production flows, production capacity and unplanned production outages. We do not, for it is bad regulation.

Benefiting from considerable energy industry expertise we point to the detrimental consequences, risks and potential unintended consequences. We further highlight the many practical and operational differences evidencing our strong opinion that transparency requirements in electricity are fundamentally different to gas.

### The Practical Operation of Gas and Electricity Markets are, by Necessity, Different:

- Electricity allows for instantaneous balancing of supply and demand whereas gas is balanced over longer periods, normally daily. Gas production and supply is significantly more flexible than electricity and shortfalls are more often than not made good within the balancing period without impacting total supply.
- From bad regulation adverse market and supply consequences will surely follow with the risk of short term, hostile trading designed to commercially benefit the trader at the expense of the producer and consumer.

### Less Liquidity but More Volatility Equals Higher Bills for Consumers:

- In electricity, balancing in the event of an outage is conducted by the TSO but this is not so for gas. Again bad regulation would lead to aggressive speculative trading and significant within-in day price volatility.
- It is useful to recall CESR/ERGEG advice to the EC in the context of the Third Package that: *"An improperly considered trade transparency initiative could lead to reduced liquidity and increase in volatility"*.

### Risking Security of Supply and a Permanent Rise in Costs:

- Production companies will inevitably consider insurance; standby storage, withheld production from other facilities or the purchase of call options. Early economic termination of older fields will also be accelerated.
- This is bad regulation eroding security of supply and rising costs to consumers. Far better to extend the successful UK model to the rest of the EU.

### Striking the Right Regulatory Balance for Natural Gas

- A key element of market design is achieving the right balance between the need for long term investment in production assets and the commercial objectives of non asset investing companies for short term traded gain. Should the interests of the latter take precedence over the former? Not in our view – trading regulation should be designed with proper regard to the underlying assets.

### EU Producers put at a significant competitive disadvantage versus non-EU Producers

- An inequitable disclosure regime applied only to EEA production would put EEA producers at a significant disadvantage compared to non-EEA producers with negative economic and security of supply implications.

### Reduction in Asset Value for Sovereign States

- Natural Resources are often owned by the sovereign state and leased to production companies. A risk from onerous disclosure requirements is reducing a state's ability to realise fair commercial benefit of their assets.

Again, Shell appreciates the opportunity to provide our comments. We would be pleased to provide any additional information that may be helpful regarding our views. We look forward to continuing our firm commitment to and support for ERGEG's work.

Kindest regards.

Yours sincerely,



Matthew Allan  
Head of Regulatory and External Affairs  
Shell Energy Europe Limited, acting through its agent  
Shell International Trading and Shipping Company Limited

## SHELL ANSWERS TO THE QUESTIONS FOR STAKEHOLDERS

### Questions

Do the existing legally binding and soon-to-be legally binding transparency requirements for transmission, LNG and storage satisfy your needs as a market participant? In case your answer is no, please specify what is missing in your view and why.

Are you satisfied with the current level of transparency provided for by system operators? In case your answer is no, please specify whether this is the case due to the lack of transparency requirements or the quality of publication.

Do the existing voluntary GGP for LNG System Operators<sup>1</sup> and GGP for Third Party Access for Storage System Operators<sup>2</sup> satisfy your needs as a market participant?

Do you think that those transparency requirements in the GGP LNG and GGP SSO which are not covered by the 3rd Package should become legally binding?

Do you think that the voluntary GGP for LNG System Operators and GGP for Third Party Access for Storage System Operators shall include further transparency requirements? In case your answer is yes, please specify what is missing in your view.

### Answers

The scale of information publication and transparency is inextricably linked to the nature of the market, in particular, the extent to which it exhibits monopoly characteristics. In that context, we would note that page 5 of the consultation document itself states that:

*'At the current stage legally binding transparency requirements are most detailed for transmission systems. Some basic transparency requirements for LNG and storage facilities are currently covered by the 3<sup>rd</sup> Package and in ERGEG Guidelines for Good Practice (GGP). Additionally, the 3<sup>rd</sup> Package offers the possibility to develop comitology guidelines for storage and LNG transparency as well.'*

Transmission networks are natural monopolies and thus need a prescriptive degree of regulation, hence the detailed and legally binding nature of the current transparency requirements. SEEL fully supports such requirements. We also fully support the requirement for LNG import terminals and storage facilities to provide information in a transparent manner to enable the market to function.

However, it is hard to understand why the requirements for competitive infrastructure might need to be as prescriptive as those for monopoly transmission networks. This is something that ERGEG may wish to bear in mind when considering the extent to which storage and LNG requirements need to be revised and/or enhanced.

Additionally, we would have a preference for ensuring that the provisions of the EU Third Energy Package and the adoption of the transparency provisions of Regulation 715/2009 remain the focus of attention. Until both sets of legislation are fully implemented, consistently applied and properly enforced across Europe, it would be inappropriate, destabilising and potentially damaging to consider the introduction of additional measures over and above those contained in the current legislation.

Question

Is there an area along the gas value chain (production, transmission, LNG, storage, distribution, wholesale market) where in your view additional transparency requirements are needed? Please specify what you miss in your answer.

Do you think that further transparency is required for the production (upstream) sector? If your answer is yes, please specify what is missing in your view, and what specific additional transparency requirements you would want to see? If your answer is no, please explain why.

Answer

This subject has become somewhat topical recently due in part to advocacy from a specific sector of the trading community suggesting that there is something deficient with the gas trading market over and above the unanimously agreed requirement to implement regulation from the Third Package and 715/2009. In particular, these parties, primarily the trading departments of European utilities, have suggested that there should be a requirement for the release of information relating to upstream gas production outages. The argument runs that this would bring gas into line with electricity markets. But this argument is flawed in many respects.

Given the location of much indigenous EU gas production, such a requirement would impact primarily on North West Europe gas markets. We make this point because consideration of the structure and operation of the two markets would suggest that in fact it is the gas market, especially in Great Britain, that compares favourably with against electricity and that any thought to share learning's should be from gas to electricity.

Furthermore, we cannot see a problem properly identified that actually needs corrective action beyond full implementation of the Third Package and 715/2009. Our view is supported by the findings from the European Commission in their 2006 DG COMP Sector Inquiry. In its findings on electricity, it specifically mentioned issues raised by users on the availability of information on generation, on balancing and reserve power, and on load. No such findings were made on gas, and calls for increased transparency were limited to networks, transit capacity and storage.

In other words, evidence and conclusions of policymakers suggests that the electricity market should look towards the gas market as a model of competition at all levels; ease of new market entry; and a highly liquid traded market.

Indeed it is prudent to question the motivation of those calling for publication of this information. Is it based on a desire to improve the efficiency of the trading market per se ? Or rather is it a desire to capture short-term commercial trading opportunities ? We think it is, unfortunately, more likely the latter.

The fact that proponents of such disclosure have adopted the use of the word 'transparency', with its widespread political and public appeal, should not be allowed to disguise this fact.

For we do not believe that general support for transparency is applicable in this instance and certainly we do not believe that supporters of transparency have in mind the intended and unintended consequences that would follow.

In pushing for immediate disclosure of information on gas production flows, production capacity and unplanned production outages, proponents do so regardless of the:

- a) Practical differences in the operations of the gas and electricity markets;
- b) Less liquidity but more volatility equals higher bills for consumers;
- c) Risks to security of supply and a permanent rise in costs
- d) Risks of striking the wrong regulatory balance for natural gas
- e) Competition law concerns
- f) EU producers put at a significant competitive disadvantage versus non-EU producers
- g) Reduction in asset value for sovereign states

## The Practical Operation of Gas and Electricity Markets are, by necessity, Different

Gas and electricity markets differ markedly in their respective physical operations. These differences preclude a simplistic read-across of the arrangements in electricity to gas.

Electricity is balanced instantaneously and generation volumes per unit are known to a high degree of accuracy. The generator knows the likely volume associated with an outage; the effects of an outage, and hence any mitigation costs, can therefore be quantified with relative ease. Indeed, the outage of an electricity generation plant is generally noticeable almost immediately by the market, which is able to track electrical frequency on transmission grids. Disclosure of electricity outages therefore represents confirmation of what is already known and the market participant suffering the outage simply pays the cash out price for that period.

Gas production, however, is a very different activity in almost every way. The gas network is balanced over longer periods (typically, a day) and actual production levels can't be estimated with the same degree of accuracy (compared to electricity generation).

However, regarding this last point, the variety of sources, e.g. storage, other fields, etc available to a gas market participant is a fundamental difference between the two markets. In effect, a producer may be able to utilise other supply sources, ensuring that an outage can be managed such that it does not impact on end-of-day nominated quantities - in other words, the supply and demand position for an end-of-day product has not changed.

Any requirement for outage information disclosure, however, would increase within-day price volatility. Yet such an increase would not be reflective of the fact that the supply/demand position had not changed.

In some circumstances, it may be that a producer does not have access to other sources of gas. In such a scenario, if they are not allowed to hedge their position before making the outage known to the market, they will in effect be forced to reveal themselves as distressed buyers.

The impact on a producer in such cases will be to push up investments costs and uncertainty. The end result could be:

- a) To make investment uneconomic;
- b) Accelerate the closure of some fields; or
- c) An increase in costs that will feed through to the wholesale market, ultimately to end up with consumers.



## Less Liquidity but More Volatility Equals Higher Bills for Consumers

At present, the NBP is the most liquid gas trading hub in Europe and outperforms various European traded electricity markets. For example, in its latest consultation on ways to improve liquidity in the GB power market<sup>1</sup>, Ofgem quotes the following liquidity levels in the various European electricity traded markets.

Table 4: Churn rates across a number of European electricity markets	GB	France	Germany	Netherlands	Nordpool
2001	3.8	0.4	5.0	1.1	7.9
2002	6.8	0.6	3.5	1.7	9.1
2003	4.7	0.7	4.3	2.3	5.5
2004	2.6	0.8	5.1	3.0	5.5
2005	2.0	0.9	6.0	3.6	6.4
2006	1.9	1.1	8.0	4.6	6.7
2007	2.7	1.4	8.5	5.0	7.5
2008	3.0	1.5	8.5	4.6	8.0
2009	3.9	1.8	9.6	3.4	7.6

Source: European Commission, European regulators, Ofgem calculations

However, NBP gas trading liquidity levels are in excess of any the above and typically range between 12 to 14. Implementation of the 3<sup>rd</sup> EU Package is expected to quicken moves towards hub trading across Europe and trading liquidity levels can be expected to rise. Further improvements will also be achieved by bringing the pan-European availability of upstream information into line with that currently available in Great Britain through the rollout of Regulation 1775/2009. Shell fully supports swift implementation of these measures and we are concerned further measures at this time may endanger speed to market in relation to enforcing both sets of legislations.

Indeed one plausible reaction to additional disclosure requirements might be reluctance to trade at hubs; this would appear at to be at odds with the signalled direction of ERGEG and DG ENERGY.

Market participants may opt to purchase expensive 'hedging' or 'insurance' products. For example, standby storage (which will increase costs and remove storage availability from the commercial market) or withheld production from other facilities. These measures could increase costs to the consumer and ultimately feed through to the development costs of new fields, presenting further hurdles to their development and in turn endangering gas production.

As a producer and trader, either outcome would concern us. An increase in costs would dampen trading activity and potentially reduce the number of counterparties. With regards to the damage to competition, consumers would be negatively impacted and that should be a concern to policymakers.

<sup>1</sup> See table 4, p11, 'GB Wholesale Electricity Market Liquidity: Summer 2010 Assessment', Ofgem, 29 July 2010

## Risking Security of Supply

We are concerned that any proposal requiring the publication of additional upstream information could not be applied in an even handed manner. Indigenous sources of gas will become less competitive and therefore investment may become less attractive.

While any proposals could be applied in relation to indigenous EU production sources, e.g. UKCS, this would only amount to 40% of EU gas supplies. The remaining 60% from countries such as Russia, Algeria, etc, would not be captured. This figure will increase given the decline in indigenous sources of gas.

Indigenous EU production would be put at a significant competitive disadvantage compared to non-EU producers who would clearly not be subject to such disclosure requirements. Additionally, investment in indigenous sources of gas would likely become less attractive.

In that context, it is not clear what would be achieved by an inappropriate set of information disclosure requirements in the context of security of supply and investment. These issues need to be addressed by the proponents of such disclosure requirements.

In another example such arrangements could deter future LNG cargoes from coming to the EU if, for commercial or operational reasons, discharge dates change.

## Conclusion

Shell supports progress towards the overall aim of facilitating the creation of a single, competitive, efficient and sustainable internal market for gas in Europe.

We support proportionate, targeted and transparent regulation and welcome the implementation of the Third Package and 715/2009 that will deliver harmonised information flows across all member states with meaningful supply information based on system entry point flows.

We believe effective transparency will be best ensured by developing regulation according to the practicalities of market operation and underlying assets and that careful consideration should be given to the significant differences between electricity and gas.

In the event of a production outage, it is imperative for a well functioning, stable and liquid market, to enable production companies to balance their market positions in an orderly manner.

Shell greatly appreciates the opportunity to respond to this consultation and trust that our comments are helpful and will be given due consideration.

## APPENDIX – ABOUT SHELL

Shell has been a leading producer of gas in Europe for decades with production in the UK, the Netherlands, Norway, Denmark, Germany and Italy, which combined with third party supplies and a global LNG position gives us an unrivalled position amongst private energy companies. In 2009, Shell produced 915,000 barrels of oil equivalent per day for the European market. Headquartered in London, Shell Energy Europe Limited coordinates Shell's European gas, power and CO2 marketing and trading business across 14 offices around Europe.

### About Shell

Shell is a global group of energy and petrochemicals companies. With around 101,000 employees in more than 90 countries and territories, Shell helps to meet the world's growing demand for energy in economically, environmentally and socially responsible ways. The parent company of the Shell group is Royal Dutch Shell plc, which is incorporated in England and Wales.

### Upstream

Our Upstream businesses explore for and extract crude oil and natural gas, often in joint ventures with international and national oil companies. We liquefy natural gas by cooling and transporting it to customers across the world. We also convert natural gas to liquids (GTL) to provide cleaner burning fuels. We extract bitumen especially thick, heavy oil – from mined oil sands convert it to synthetic crude oil.

Our Upstream businesses are grouped into two organisational units: Upstream Americas, covering the Americas, and Upstream International, covering the rest of the world with major interests in Europe, Asia/Middle East/Russia, Australia/Oceania and Africa.

### Downstream

Our Downstream organisation is made up of a number of businesses. Collectively these turn crude oil into a range of refined products, which are moved and marketed around the world for domestic, industrial and transport use. These include fuels, lubricants and bitumen.

Our manufacturing business includes Refining, Supply and Distribution. Marketing includes our Retail, Business to Business (B2B), Lubricants and Alternative Energies and CO2 management. Our Chemicals business has dedicated Manufacturing and Marketing units of its own. We also trade gas, power, crude oil, oil products and petrochemicals primarily to optimise feedstock for our Manufacturing business and to supply our Marketing business.