



International Association of Oil & Gas Producers

Response to:
**EREGG Public Consultation on
Existing transparency requirements for natural gas**

E10-GWG-68-03

8th September 2010

22nd November 2010

Dear Sirs,

The International Association of Oil & Gas Producers (OGP) welcomes the opportunity to respond to ERGEG's consultation on existing transparency requirements for the natural gas market. We set out below our response to the final two questions in the consultation document as these questions have the most relevance to gas production:

- **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 additional transparency requirements you would want to see? If your answer is no, please explain why.**

Introduction

OGP recognises that reliable and timely supply information is integral to a much wider set of fundamental data for both electricity and gas that are necessary to further the creation and operation of liberalised, competitive and liquid traded energy markets in Europe. We recognise too the presently fragmented and inconsistent nature of information provision across the EU, with a number of Member States still working towards compliance with transparency requirements laid out in the Second Gas directive and EU Third Energy Package. Indeed, the ERGEG consultation document usefully lists all of the existing legally binding transparency requirements across the EU. They are substantial and, to our knowledge, have yet to be fully implemented. This must be done in a consistent manner across the EU. We therefore broadly welcome initiatives that seek to improve and harmonise natural gas market transparency and reduce uncertainties which adversely affect future investment in the energy sector and hence security of supply.

Key to the success and utility of such initiatives is that they should be both evidence-based and guided by clear objectives. Transparency can serve many different purposes and can serve the interests of different market parties in different ways. Moreover, there is almost always a natural presumption in favour of more and more information provision.

But, in reality, the provisions of competition law, the interests of consumers and the practicalities of market operation necessitate genuine practical boundaries to this.

In this context we would like to offer the following observations.

Building the Case for More Information

We realise that the current consultation is an exercise aimed at understanding the needs and wishes of a broad spectrum of market participants, but, as a matter of good regulatory practice, this should not be a substitute for defining clear objectives or for presenting evidence of shortcomings in existing arrangements for which improvements may be needed. As currently presented the consultation questions invite unsubstantiated views and thus risk persuasion by arguments founded purely on the commercial self-interest of individual parties and/or different market sectors, furthered by a belief that there are no boundary conditions. Thus, if ERGEG's recommendations from this exercise are to be credible, even-handed and workable a demanding threshold for supporting evidence will need to be set, though we note that any reference to the need for such evidence is missing from these two particular questions.

This is particularly pertinent in light of the ongoing implementation of the provisions of the Third Energy Package and the adoption of the transparency provisions of Regulation 715/2009 that together will set a new benchmark in information on market operation across the EU. The level playing field prescribed by these two important pieces of legislation will drive significant improvements in gas market transparency. But until they are fully implemented, consistently applied and properly enforced, it would be premature, and potentially detrimental, to press for additional measures. **Indeed, it will be challenging for parties responding to this consultation to point in any meaningful and quantifiable way to where improvements are justifiably required whilst Member States are still to implement these obligations fully.** And seen against this evolving landscape it would run entirely counter to the principles of better regulation to impose additional requirements without a fully justified case for doing so.

The Practicalities of Market Operation: Differences between the Gas and Power Markets

Much of the current debate on improvements to energy market transparency follow the findings of the EU Commission's 2005 Energy Sector Inquiry (ESI) and the subsequent focus on vertical integration and lack of transparency in the power markets. In progressing work to address these shortcomings it may be appealing to consider how many of the new arrangements can simply be transposed directly to the gas market, but here some key distinctions must be made between the two. Fundamental differences between gas production and electricity generation¹ have an

¹ The ESI recognises there to be some obvious differences between the gas and electricity sectors while also a number of similarities and inter-relationships. Paragraph 5 on page 18 of the full report states these differences. See also paragraphs 36, 324 and 327.

important bearing on the design and operation of an effective information disclosure regime and call for parallel but differentiated approaches:

- **Balancing periods:** Unlike the electricity generation market, in which there is an instantaneous requirement to balance supply and demand, gas is balanced over much longer periods, usually daily. Gas production and sales contracts are typically based around a Gas Day concept in which gas is sold on the basis of an end-of-day quantity, and the regime is designed to cope with the within-day variations of flow that occur in the normal course of events. In sum, there is no physical rationale to support the hourly balancing, which is though a clear barrier to entry in the market. It is therefore understandable why daily balancing of the gas market is the preferred option of the European energy regulators.
- **Aggregation:** Gas supply is far more elastic than that for electricity. Unlike the electricity market in which each generation unit is discrete and independent, gas production facilities tend to be linked to gas gathering systems, of which there can be several at any given entry point to a Transmission System. 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 a confirmation of what is already known. This happens in a very short timescale because of the instantaneous nature of transmission and the co-location of production and supply. Gas production on the other hand can be located long distances from the supply market and it can take a number of days to travel along the transportation pipelines. In the event of an outage at any single production installation, the 24-hour balancing period provides for end of day quantities to be made up in a variety of ways:
 - Flows from the same installation at a higher rate later in the day, to ‘catch up’;
 - Using gas in the pipeline (linepack) to manage end of day deliveries;
 - Increasing production from another source within the same gas gathering area (this commercial practice is known as ‘substitution’, where operators tend to hold balance accounts or contracts with other operators to optimise the reliability of gas deliveries);
 - Turning up spare production from another source within a company portfolio;
 - Using storage capability to meet customer demand.

The important conclusion from these operational differences between the gas and power markets is that gas production is significantly more flexible than electricity generation. Shortfalls in supply from any one source or the outage of individual installations can be, and most often are, made good within the balancing period and have no impact on total supply.

Market Volatility – The Consumer Pays

The operation of a “gate closure” mechanism in the electricity market means that in the event of an outage at a power station the balancing obligation is removed from the generator and balancing actions are conducted by the TSO. This means that whilst the market is aware of the outage, **the generator is not exposed for these particular periods to becoming a distressed purchaser**, thus

avoiding distorting the market with price jumps or additional volatility. The market participant suffering the outage simply pays the cash out price for that period.

No parallel arrangement exists in gas production. Thus any requirement to disclose instantaneous production outages would most likely lead to within-day gas price volatility. Moreover, recognising the gas supply flexibility that exists within the normal 24-hour balancing period, such volatility would be driven not by supply/demand fundamentals but rather by speculative positions taken by parties seeking to exploit market reaction. Caution therefore needs to be exercised in responding to further calls for production information disclosure for fear of driving un-necessary wholesale market price volatility, with benefit only for a very narrow set of market participants at the expense of the consumer.

Publicising an outage before a position can be balanced also advertises a short position and reveals a distressed buyer. This will add unnecessary costs to the already significant costs a company faces when production has been cut, and risks a permanent rise in supply costs if field owners are forced to hold additional “insurance” to avoid such an exposure. For example, standby storage (which will increase costs and reduce storage availability in the commercial market) or withheld production from other facilities. This may also accelerate early economic termination of older fields where fluctuating production increasingly tends to occur. Producers might also choose to purchase call options which can be exercised in the event of an unforeseen outage. These measures could serve to increase wholesale costs and eventually the costs to consumers. Ultimately such costs could feed through to the development costs of new fields and present a further hurdle to their development, thereby endangering indigenous gas production, with the associated security of supply risks.

Production owners placed in distress by a supply failure should therefore have a period of time between the failure occurring and the reduction in flow-rate becoming apparent at the system entry point, in which to cover their position before disclosure is necessary. Such action represents the best way to avoid unnecessary turbulence in the markets and is in the best interests of the consumers and the wider gas community.

In summary, the premature disclosure of outages and other production activities can create misinformation and thus unnecessary market price volatility. In accordance with long established practices in recognised commodity markets the gas producers, who sell gas (days, weeks or years) ahead of the supply period, should continue to be able to cover their physical positions if they suffer an unexpected outage. Restricting such orderly management of supply with demand risks causing greater price volatility, with:

- **Potential costs feeding through to consumers, as well as producers;**
- **Greater uncertainty in supplies during times of high demand or system stress;**
- **A potential impact on future investment in European indigenous production, as a potential competitive disadvantage is created in relation to third country producers;**
- **A progressive erosion of security of supply.**

Implications for Security of Gas Supply

In contrast to the electricity market, in which the EU is essentially self-sufficient (and most Member States are individually self-sufficient), the EU gas market is increasingly reliant on imports from Russia, Algeria, Norway and global LNG markets. Presently, the disclosure of upstream information from indigenous production would apply to less than 40% of EU gas supplies, and this percentage will decrease as indigenous production declines in the years to come. Thus, an inappropriate disclosure requirement risks putting indigenous production by EU and Norwegian (EEA) producers at a significant disadvantage relative to competing non-EEA producers not subject to such disclosure requirements. Non-EEA producers would clearly stand to benefit from early disclosure of production outage information by EEA producers. If badly designed, information disclosure requirements could harm rather than enhance security of gas supply. For example, such arrangements could deter future LNG cargoes from coming to the EU if, for commercial or operational reasons, discharge dates change.

Competition Law

The exchange of commercially sensitive (i.e. strategically useful) information risks (actual or perceived) coordination of companies' competitive behaviour resulting in restrictive effects on competition. Care is therefore needed to ensure that the scope and timing of the information disclosed does not simply enable certain categories of customers to take undue advantage of the information to the detriment of other competing suppliers and customers.

Conclusion

OGP broadly supports measures to improve natural gas market transparency and reduce uncertainties which adversely affect future investment in the energy sector. Effective transparency is best ensured through a framework in which information disclosure obligations are established according to the practicalities of market operation and are balanced in the interest of consumers and all other market participants. Furthermore, the degree and nature of the transparency must not be such as to create "artificial transparency" giving rise to competition law concerns.

In many NW European markets significant usable production information is already provided to the market in real time. Elsewhere, TSOs still have to implement such reporting of information. There needs to be consistent provision of information at all major entry / exit points for all TSOs. When this has become well and uniformly established across the EU, its proper functioning should be independently assessed and verified. Only in the event of manifest failure should any further obligations be contemplated.

It is not appropriate, and it is potentially damaging, to implement arrangements that apply to electricity markets in the gas market because they are fundamentally different in terms of structure, functioning and technical operation.

Indeed, rather than improve the functioning of the natural gas market, OGP is concerned that an inappropriately designed, one-size-fits-all obligation for the disclosure of natural gas production information is likely to create unintended and adverse consequences e.g. an increase in volatility of prices across the market that will have impacts for consumers and producers alike.

Furthermore, indigenous production risks being disadvantaged vis-à-vis competing non-EEA sources of supply, particularly in the short-term traded markets. This will introduce additional costs of compliance, put major external suppliers at a competitive advantage and could jeopardise EU security of supply because indigenous sources of supply may attract less investment.

A common EU regime for the disclosure of information regarding the production of natural gas should be founded on meaningful supply information based on system entry point flows. This implies the following:

- Any requirement for the disclosure of production information must represent the balanced interests of all market participants - supported by evidence;
- In the event of a production outage at a given installation the production owners should be given an opportunity to take measures to prevent the production outage from resulting in a reduction of supply, including the use of the available data to balance their market position;
- OGP does not support speculative trading activity using outage information, as this will increase price volatility resulting in increased costs to the consumers;
- Natural gas production information should be aggregated by system entry point and made public by the appropriate transmission system operator (TSO).

In light of the above, OGP supports the implementation and subsequent co-ordination of transparency under EC No. 715/2009 – i.e. harmonisation of information flows across each of the 27 Member States. This will initially become the responsibility of ENTSOG.

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About OGP: The International Association of Oil and Gas Producers (OGP) represents the interests of companies engaged in the exploration and extraction of oil and natural gas, as well as national and other related industry associations. OGP membership spans the globe and accounts for more than half the world's oil output and about one third of global gas production. From our London office, we foster co-operation in the area of health, safety and the environment, operations and engineering, and represent the industry before international organisations such as the UN, IMO and the World Bank, as well as regional seas conventions, such as OSPAR, where we have observer status. OGP Europe in Brussels represents before the EU OGP members who are active in Europe.