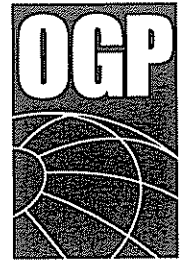


Sir John Mogg  
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International  
Association  
of Oil & Gas  
Producers

Brussels, 18 January 2006

### **OGP Comments for the ERGEG Roadmap for a Competitive Single Gas Market in Europe**

Dear Sir John,

The International Association of Oil & Gas Producers (OGP) welcomes the opportunity to provide comments to the ERGEG proposed road map for a competitive single gas market in Europe discussion paper released in November 2005 and to issues which have been raised to stakeholders involved in the Madrid forum and in the gas market.

OGP *inter alia* represents the interests of companies engaged in the exploration and production of oil and gas in Europe as well as many of the national oil industries associations, towards the European Union. About 55 percent of Europe's demand for gas and approximately 40 percent of its demand for oil are currently met by indigenous production. OGP membership also spans the globe and accounts for more than half of the world's oil output and about one third of global gas production. Companies and institutes, represented by OGP, are the largest investors in exploring for oil and gas, developing oil and gas projects and related research and development technologies.

Oil and gas producing companies have welcomed gas liberalisation as having the potential to underpin long and short term security and diversity of supply. This will be best achieved by promoting transparent and efficient economic signals between gas consumers and suppliers, including the particular value placed on supply reliability. We believe in the principle of liberalisation. However, in order to liberate commercial forces, a level playing field for competition needs to be established.

OGP appreciates the ERGEG road map initiative and believes that a road map, in particular when joint agreement and adoption on such a road map can be achieved through the Madrid Forum, could contribute to deliver confidence in a stable and coherent European regulatory framework for natural gas. This is of importance if Europe is to stimulate the necessary investment required to secure future external supplies of natural gas.



## **Security of supply - need for an external dimension**

The ERGEG paper identifies a series of important issues related to the functioning of both the individual Member States' natural gas markets, and the overall internal market. However, the road map could be seen to be too much internally focussed in terms of the identified potential barriers and remedies.

In the future the EU will increasingly depend on sources of natural gas flowing from outside its borders. In addition, the depletion of indigenous sources means that intra-EU flows of natural gas will have to increase. Hence to meet growing demand capacity enhancement will have to take place at three levels:

- Development of additional gas production capacity from new, further afield sources;
- Expansion of existing import infrastructures;
- Intra-Member State capacity flow enhancement.

The above means that in the future sellers and importers alike will have to manage an increasing variety of regulatory and fiscal regimes that, importantly, are not designed to serve the same purposes.

Export, transit and consuming countries all have different regulatory objectives. The challenge is to align these interests so as to make sure that the necessary investment is carried out in a timely fashion. A regulatory chain that is considered to be fragile or unpredictable, or lacks consistency will constitute a considerable impediment to such investment being carried out.

Europe will thus have to face the reality of natural gas markets becoming global, and policy and regulatory developments will have to be adapted accordingly. OGP is of the view that Europe needs a policy and regulatory framework that balances short-term efficiency and flexibility through effective market mechanisms and strategic long-term supply security measures that clearly recognise the realities of international supply competition and the role played by transmission countries.

OGP generally believes that policy makers and regulators alike should focus their efforts on establishing frameworks at national and international level. These should provide the appropriate conditions and incentives to bring on the new supplies and infrastructure that the future market will require. In this respect OGP supports ERGEG's view that regulatory frameworks ideally should mesh.

## **The role of long-term contracts**

OGP has engaged intensively in the debate on long-term contracts and appreciates that both, the Gas Directive and the Security of Supply Directive acknowledge the importance of such contracts. The fact that these contracts are again questioned (in the ERGEG road map and also in the DG COMP sector review and by national competition authorities) is undermining confidence and is a matter of concern for OGP.



For example, as others have done recently, the ERGEG road map (in paragraph 107) makes reference to the recent Court of Justice ruling in respect of certain legacy electricity contracts. We do not agree with the implication that the ruling might support a challenge to "legacy contracts". In our view, the case dealt with a very specific and limited fact scenario and, therefore, the ruling has limited, if any, wider implications for other gas contracts generally.

In committing large capital investment to gas projects, account has to be taken of the total balance of risks, including price, geology and technology uncertainties, market supply / demand balances and market liquidity. European markets have historically been able and willing to mitigate these off-take uncertainties for large gas investment through long-term take or pay contracts, and this has been an important part of sharing the commercial risks.

Long-term contracts exist to manage investment risk and are contributing to security of supply. Mostly, the substantial investment undertaken in the gas industry requires long-term contracts. If circumstances allow, other contracts are conceivable and do exist. Taking Europe's increasing import dependence into account we believe, however, that a major part of gas supplies for Europe will continue to be based on long-term contracts.

In line with this, financial institutions predict that long-term contracts will continue to be necessary in the future to secure non-recourse financing of gas development, storage and/or pipeline projects. Apart from supporting security of supply, the option to enter into long-term contracts provides additional choice to buyers. In an effective market, buyers should have a range of supply options, be they long-term, short-term or spot purchases. By entering into a mix of commercial arrangements the buyers are able to set their own level of supply security.

### **Short-term trading and long-term supply markets**

OGP sees a valuable role for short-term and traded markets alongside long-term supply contracts. The development of trading hubs across Europe has added flexibility to the market enabling players to balance their contract portfolios and realising short-term efficiency gains.

However, two fundamentals need to be remembered. First, trading hubs, through their price signals, improve short term efficiency in redistributing existing supplies. As such, trading hubs do not contribute to increased supplies. Second, for hubs to provide price signals they need to be underpinned by a sufficient degree of liquidity.

Although the number of parties present at a hub is important, the depth of liquidity in traded gas markets will ultimately depend on the volumetric supply/demand balance. If supplies are not sufficient, and new investment in production and transportation capacity are inadequate, it follows that market liquidity will become limited. Even though it can be seen as a paradox, long-term contracts are, because they are instrumental in ensuring sufficient supplies to Europe, at the very base of creating any degree of liquidity at hubs across Europe.



Long-term contracts represent the back bone of the portfolios that the industry players will seek to balance. An increasing variety of long-term contracts, both in terms of length as well as price and delivery point provisions, will require an increasing need for balancing and hence underpin the role of trading hubs. It can thus be argued that what in the longer term will deliver both increased hub trading as well as security of supply in Europe is the existence of long-term supply contracts for natural gas.

### **A coherent regulatory framework**

Investment in oil and gas production facilities and infrastructure often involves billions of Euros and requires sophisticated funding from banks, multi-lateral financing agencies, as well as companies. Therefore, stability and predictability of tax and regulatory regimes are critical to secure the investment, repay loans and for the recovery of the investment.

Changes that could adversely impact the economics of existing projects and those that are foreseen will have serious consequences for new investments and for the security of energy supply. The implementation of regulations must strike the right balance between the objective of securing future gas supplies, building new infrastructure and developing a competitive market.

Achieving a coherent regulatory framework both within the EU and at its borders is of great importance. OGP is of the opinion that this also requires continuous regulatory development in response to changing conditions within and outside the EU. Such continuous development needs to be carried out without undermining the sentiment of there being regulatory stability or predictability allowing for long-term planning of infrastructure and supplies. Strong and independent national regulators with the capacity of acting coherently across adjacent markets then becomes an important feature in creating the necessary conditions for investment and supplies. In this context, it is worth noting that regulatory gaps may be as problematic as regulatory overlaps when it comes to creating uncertainty, confusion and additional costs.

With the above in mind we share the view of the European Commission that it would currently be premature to contemplate further legislative measures at EU level. Now is the time to consolidate and see that existing legislation is transposed into national law in a manner that contributes to securing a functioning European market for natural gas, a market that should be able to attract the significant investment required for the natural gas to be directed to Europe. In this respect OGP also looks forward to seeing the outcome of the Commission's review of such national legislative implementation announced for the end of this year.



OGP would like to underline that where a need for interpretation is identified in the legislative framework, voluntary industry agreements can be an efficient way of providing guidance. Such agreements have the potential of being more rapidly achieved than full legislation or regulation. They might also allow exploring in less onerous terms a series of alternative measures or remedies to a particular problem. Such agreements also need to be given the time to work, before a judgment is made and legislation/regulation is considered. Therefore, although OGP sees the problem of an entire regulatory framework based on voluntary agreements, we fail to see there being significant risks related to the use of voluntary guidelines as an instrument to mend regulatory gaps.

### **A way forward**

With regard to the proposed regional approach, OGP sees the need for a more holistic and harmonised move forward to avoid fragmentation of policy and regulatory developments. To that end OGP recommends to combine the ERGEG proposal and the regional initiative described in the DG TREN benchmark report where this would add to efficiency and simplicity. With the lack of integration between national markets identified by the Commission as an important shortcoming of the current state of the market, an identification of individual regions across Member States subject to particular regulatory focus might possibly stabilise market segmentation.

That said, it should be recognised that for hub-to-hub trading to develop coherently, a pan-European approach facilitating such trading is facilitated through joint regulatory action should be considered.

OGP suggests developing the road map by taking full account of the impacts on longer-term investment and security of supply including thoughts of how to encourage a competitive longer-term market to develop. As referred to above, OGP would welcome the roadmap to include both a broader external dimension and development of the current document into a road map that can be endorsed and adopted by the entire Madrid Forum and as such become a joint product of all stakeholders.

We hope that our comments will help in further refining of the road map and we remain at your disposal for any further comment you might wish to request from OGP.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Norbert Liermann'. The signature is fluid and cursive, written in a professional style.

Norbert Liermann

Manager EU Affairs  
The International Association of Oil and Gas Producers