International
Association
of Oil & Gas
Producers

Mr. H. Schmitt von Sydow
Director of Directorate C
Conventional Sources of Energy
Directorate-General for Energy & Transport
Commission of the European Union
200, Rue de la Loi
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OGP Comments for DG TREN Benchmarking Report 2005

Dear Mr Schmitt von Sydow,

The International Association of Oil & Gas Producers (OGP) welcomes the opportunity to provide an assessment with respect to the questions you have posed to all stakeholders involved in the Madrid and Florence regulatory fora.

OGP 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 60 percent of Europe's demand for gas and approximately 40 percent of its demand for oil are currently met by indigenous production. The 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.

As you know, OGP very much supports DG TREN and the Madrid Regulatory Forum in continuing the debate on the implementation of the Gas Directive. We are aware of the particular status the corresponding report scheduled for the end of this year will have, because it will focus on the full opening of the market by July 2007. In welcoming the chance to participate in this debate, we would like to put forward our general positions and evaluations to your specific questions from a gas exploration and production perspective.

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1. Current developments of the gas markets in Europe

The EU gas market continues to expand and the demand is projected to grow by 1,8% per year according to the projection of the World Energy Outlook of 2004 - with the most rapid growth for gas rather than non-hydro renewable energy. The power sector will be one of the main drivers for additional gas demand. Natural gas demand is also projected to grow in other areas of the world and some of these regions will change from self sufficiency to that of being net importers. This will have an impact in the world gas trade patterns. For Europe this will mean an increase of imports over long distances including an increase in LNG shipments and a growing number of LNG terminals. The EU's indigenous gas production potential will also continue to be significant; even if there are challenges arising from the maturity of its producing basins. These resources will continue to make a valuable contribution to Europe's future energy supply.

These changes in the European supply and demand pattern have been recognised and are being addressed by the Commission and the market participants as an increasing supply risk. Therefore, mitigation measures, as outlined in the Green Paper "Towards a European Strategy for the Security of Energy Supply", have been proposed and are increasingly being implemented. These include a multiplication of gas transport routes, the further integration of the European gas network, and a continuous dialogue with the gas producing countries. Furthermore, contractual freedom within the competition law and the important role of long-term contracts has repeatedly been addressed.

The oil and gas producing companies have welcomed gas liberalization as having the potential to underpin short and long term security and diversity of supply. This will be best achieved by promoting efficient economic signals between gas consumers and suppliers, including the value placed on particular levels of supply reliability. We believe in the principle of liberalization and that in order to liberate commercial forces, not only does a level playing field for competition need to be established but that regulation should also be proportionate to meet these objectives. It is the view of OGP members that legislative changes should only be developed with a good understanding of their consequences. For example, movements in the gas price are a natural component of open, reactive and efficient markets, where they help balance supply and demand by providing important and transparent signals to buyers and sellers.

Investments often involve billions of Euro's and require sophisticated funding from banks, multi-lateral financing agencies, as well as companies. Therefore, stability and predictability of tax and regulatory regimes is 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 application of regulations and their enforcement in our view should be seen to strike the right balance between the objectives of securing future gas supplies, building new infrastructure and developing a competitive market.

We believe that the full implementation and application of the Gas Directive should foster market opening. Additionally, a range of technical activities such as those initiated by the Madrid Forum and currently worked out by EASEE-gas will serve to identify and relieve constraints in interconnections and improve interoperability.

By encouraging new investments within Europe, Article 22 exemptions will enhance the diversity of interconnection and market security. The Commission must be commended for its demonstrated willingness to endorse exemptions under Article 22 for a growing number of significant new projects. In addition to security of supply improvements, market forces in a competitive market will push for increasing interoperability within Europe.

2. Likely future developments of the gas markets in Europe

The European gas industry will continue to supply secure energy in substantial quantities. There is no shortage of accessible gas resources within and outside the EU / EEA areas to achieve sustained, long term gas production. According to figures assembled by OGP, the estimated remaining recoverable EU /EEA natural gas resources amount to some 12,000 standard billion cubic metres (bcm). Given realistic assessments of annual production rates, this resource base is expected to sustain significant levels of EU /EEA consumption also in the long term. The members of OGP are currently undertaking investments amounting to multi-billions of Euro to deliver new gas supplies and infrastructure for the EU. These investments include new overseas LNG export facilities and European re-gasification terminals that will help diversify future gas supplies to Europe.

Global gas reserves are sufficient to also meet the expected world demand for most of this century. At least 70 percent of global gas reserves lie within economic reach of the EU. Europe must expect, however, to increasingly compete with the US and Asia Pacific markets for supplies and therefore will need to provide a competitive regulatory framework in which markets can continue to develop. If they do so, then there are sufficient economical supply sources and the producers will be able to meet Europe's gas demand.

Indigenous gas resources will continue to play a substantial part in the supply of the market, albeit with decreasing volumes over time. OGP has in two meetings of the Madrid Forum given reports on the gas supply situation in and for Europe. The analysis and examples from other hydrocarbon plays has shown that the natural decline in indigenous production can be mitigated i.e. through the application of modern technologies to assist development of resources, which are currently marginal, before the existing infrastructure must be abandoned. These resources will become available, only if the regulatory and fiscal framework conditions are proportionate and predictable.

Many new projects designed to bring new external gas supplies to the EU / EEA market entail long lead times and payback periods and require returns reflecting the risks and high capital costs. In committing large capital investment to gas projects, account has to be taken of the total balance of risks, including geological and technical uncertainties, market supply/demand balances and market liquidity. The European markets have historically been able and willing to mitigate these uncertainties for large gas investments through long term contracts. This has been an important part of risk sharing and project financing.

New sources will be more remote with growing technical challenges and increasing capital costs involved. This is why regulatory certainty is important. As liquidity develops, some aspects of the market may be evolving to structures with variable duration of contracts. In view of the various risks and the terms of financing, there will, however, be a continued need for long term contracts. Provided that such contracts meet the requirements of applicable competition law there should be freedom for the participants to agree on the commercial structure, duration, pricing basis etc.

It can be expected that as the supply and demand picture changes, market prices may change or become more volatile. Price movement will provide the necessary and important signals for the market to react and ensure that supply and demand remain balanced.

3. Whether improvements to any aspect of the market opening framework should be explored either at national or Community level

It remains OGP's view that stability and predictability of the regulatory framework are of highest importance. Since the market opening framework through the Gas Directive and an active Madrid Forum are in place, we believe that this debate should therefore primarily be conducted at the Community level and focus on the implementation of the framework, and with urgency placed on interoperability questions. Our members are involved in the European Association for Streamlining Energy Exchange – Gas (EASEE-gas) and as such directly involved in developing a Common Business Practice (CBP) on the quality harmonization of high calorific gas. Recognizing the complexity of the issue we also see a need for intensifying the dialogue at a national level to create urgency for removing any possible legislative or competitiveness obstacles, should these exist. We also see a need to explore means for simplification of permitting and exemption, this would help to decrease project uncertainty and avoid delays.

The debate preceding the adoption of the Gas Directive and thereafter has shown that demands for short term liquidity have to be balanced with considerations of security of supply. We continue to be of the opinion that import dependence as such is not a problem, but we are concerned about the renewed debate around the validity and necessity of long-term contracts. We appreciate that the validity and indeed necessity of such contracts has been endorsed in the Gas Directive as well as the Security of Gas Supply Directive. Recent developments, however, show that competition authorities, at a national as well as European level again question such contracts.

4. Whether any reinforcement to measures to protect the interests of consumers need to be considered

As an organisation representing upstream interests, OGP believes in an effective implementation of the Gas Directive and would support measures to protect the interests of customers, should an assessment reveal the need. As a general remark we support the development of a competitive market with a level playing field equally fair for all participants. It is important, however, for all market participants to clearly understand their roles and responsibilities and that open competition in gas markets should not be pursued to the detriment of integrity, efficiency, reliability and other aspects of customer service or to the longer-term prospects of the gas system as a whole.

We hope that our comments will help in the preparation of the DG TREN 2005 Report on the functioning of the electricity and gas directives, we remain at your disposal for any further comment you might request from OGP.

Yours sincerely,

N. Liermann

Norbert Liermann
Manager EU Affairs