Reaction of Energie Beheer Nederland to the Draft Preliminary Report on the Energy Sector Inquiry

General remarks

The Inquiry has corroborated that the structure of the internal gas market in Europe currently has a number of shortcomings. These are related to five main issues: concentration, vertical foreclosure, a lack of market integration, a lack of transparency and price issues.

1. We agree that the functioning of the internal gas market leaves a lot to be desired. And we agree that market integration is of the utmost importance. Sufficient transport capacity between the member states, transparency and well functioning secondary markets are examples of measures that can help integration of regional markets in Europe.
   On the other hand however, a lot has been accomplished in a relatively short period of time, especially considering the fact that the creation of an internal energy market in Europe requires a very complex transition process. In member states that have loyally implemented the directives only a couple of years ago, like the Netherlands, we have seen new players entering, the incumbent losing a substantial market share, hubs growing quickly in terms of volume and liquidity, etc. So EBN supports the policy of the Commission aimed at full implementation of the directives in all member states.
   To structurally improve the functioning of the gas market in the Netherlands, market integration with neighboring countries is a precondition. Only by increasing the scale of the market, in terms of volumes and the number of players, a sufficiently liquid market can be established and the issue of the (national) dominance of the incumbent resolved.

The Draft Report considers market concentration to be the biggest shortcoming of the gas market. "Gas incumbents remain dominant in their national markets by largely controlling gas imports and/or gas production." (page 37, conclusion)

2. The Commission considers market concentration to be the biggest problem with respect to the functioning of the internal market. Looking at the issue on a national scale (as the Report generally does), this could be the case. But on a European level EBN tends to disagree.
   The European gas market will no doubt further develop towards a structure in which a number of large, financially strong companies will dominate. In view of the specific characteristics of the gas market (a limited numbers of suppliers, the need for large investments in infrastructure, the financial risks involved in gas trading and the economies of scale) this will also be in the interest of consumers, because it will contribute to an efficient and secure gas supply.
   There are other well functioning markets, where economies of scale have driven the industry towards comparable degrees of concentration. So concentration in itself is in our mind not the real problem. And, as said before, we consider market integration as the best way to address the issue of dominance of incumbents on their national market. In combination with the approach the Commission proposes with respect to implementing the directives, transparency and vertical foreclosure, this can go a long way in creating a well functioning gas market in Europe.

Upstream issues

Looking more specifically at the upstream issues the Preliminary Report addresses, EBN would like to make the following comments. We do so from the perspective of a State owned company, that is executing the gas policy of the Dutch government, especially with respect to maximizing exploration and production (E&P) from the gas reserves in the Netherlands.

"Competition between upstream producers *outside* *the EU falls outside the scope of the sector inquiry." (page 28, nr. 68)*
"The Inquiry has confirmed that foreclosure of the downstream market by long-term contracts is an immediate priority …" (page 6)

3. The Preliminary Report states that the upstream part of the gas market is not taken into consideration, at least where producers outside the EU are concerned. But consequently in the way the Dutch market and more specifically Gasunie Trade & Supply is pictured, the Report abstracts from the fact that the infrastructure and contracts in place are to a large extent determined by the production of gas in the Netherlands. Gasunie Trade & Supply should therefore be compared with Gazprom or Statoil, rather than with E.ON Ruhrgas or Distrigas. Dutch producers need a level playing field to compete with producers outside of the EU.
   This is specifically relevant for the way transit issues and long-term contracts are treated. For producers to invest in exploration and production of natural gas and for transportation companies to build the pipelines that are necessary to transport the gas to the markets, long term contracts (for a considerable part of the reserves involved) are necessary. This is the case for Russian gas as well as for Dutch gas, at least as long as the liquidity in the market is not enough to reduce the risk.
   EBN can therefore support the Commissions focus on downstream long-term contracts, but stresses that Dutch long term (export) contracts should not be included, as these clearly concern the sale of gas that is produced in the Netherlands. This also regards the related transport arrangements, entry into the Dutch grid and exit to neighboring countries.

In almost 90% of cases where two or more producers are selling from the smae field to the same wholesaler, the price indexation in the long-term contracts is the same. Furthermore, in almost two thirds of these cases, the same actual price is being paid by the wholesaler to the producers." (page 94, conclusion)

4. The Report suggests that different companies, selling gas from one and the same field, should be expected to sell the gas under different (price)conditions. Judging on the basis of long time Dutch experience -and as partner in most E&P joint ventures and policy advisor we are in a position to do so- this assumption is not realistic. Even where producers sell the gas separately, price and conditions tend to be more or less similar, since the quality, production profile and entry point will be the same.
   We look at the Dutch E&P joint ventures as independent companies. They are operated by one of the partners, for the account and risk of all partners. By doing so, they can spread the risk of E&P-activities over more ventures. The gas from one field -certainly in the case of very small fields, is generally sold to one buyer, under the same conditions. So every partner has the same contract with the buyer for his part of the gas that is sold. It would be very inefficient to do otherwise, since selling the gas separately, under different conditions, would require separate marketing

activities, balancing agreements, etc., so would be more costly. And where the buyer has a dominant position, he is not allowed to buy the gas under different (price)conditions.
When partners do sell their gas separately, as happens from time to time, price and conditions tend to be more or less the same. With the market developing towards more liquidity, in the future this will be the case even more often.
In the case of most Dutch gas fields, sold on the basis of a field depletion contract, the volumes involved are too small to have any consequence for supply competition. While an obligation to sell gas separately, to different buyers, would be (another) blow for the Dutch Mining climate, thus threatening production from small fields, creating even more need for imports from outside of the European Union.

Heerlen
1 May 2006