

# Shell response to ERGEG discussion paper on gas balancing

## September 2005

### Introduction

This response of Shell International Exploration and Production B.V. and Shell Energy Europe B.V. ("Shell"<sup>1</sup>) to the request for public Consultation by the European Regulators Group for Electricity and Gas (ERGEG) on gas balancing consists of three parts:

1. General observations
2. Responses to the "key questions" raised by ERGEG
3. Comments on the suggested changes to the CEER gas balancing principles

### General observations

Shell welcomes market development in the European gas market. Throughout Europe Shell companies own and operate gas production, have interests in LNG imports, and are active as wholesale shipper, trader and supplier to industrial and commercial customers.

Shell agrees that the market has the primary responsibility for gas balancing and that the TSO (Transmission System Operator) retains a residual system balancing role, driven by safety and cost efficiency.

Shell advocates a light form of regulation so that market participants can act on developments in the market. In particular, regulation related to gas balancing should be designed to ensure safe and efficient operation of the gas transmission system. Shell supports further interoperability of the gas balancing regimes across Europe.

In the coming years significant investments will be required to satisfy the growing demand for gas in Europe. This requires a healthy investment climate. Investors should be able to rely on a clear, stable, and predictable regulatory regime so that the basics underlying their investment decisions will not be undermined, ownership rights will be respected and contracts will be honoured.

The design of the gas balancing regime and balancing period has a significant impact on the safe and efficient operation of the national and regional distribution networks

As a producer, Shell would like to stress that many upstream production facilities (such as wells, sub sea installations, and upstream processing facilities) have minimum flow requirements and restrictions on ramp up / down rates. These facilities have not been designed to change production flows on a frequent (hourly) basis. Doing so could jeopardize the safe and efficient operation, will increase cost and could ultimately have a negative impact on the recovery of hydrocarbons from the reservoirs. This is particularly the case for upstream systems producing so called associated gas where any variations in flow also impacts on liquids production.

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<sup>1</sup> The companies in which Royal Dutch Shell plc directly and indirectly owns investments are separate entities. In this response the expressions "Shell", "Group" and "Shell Group" are sometimes used for convenience where references are made to Group companies in general. Likewise, the words "we", "us" and "our" are also used to refer to Group companies in general or those who work for them. These expressions are also used where there is no purpose in identifying specific companies.

We differentiate between the physical and the commercial elements of balancing.

Physical balancing is a key part of the TSO's role. In principle this is a continuous process. Gas transport networks heavily rely on physical imbalance to operate the pipeline system safely and efficiently. In many cases peak consumption can only be provided if the system is "pre-loaded" with gas. In such a system physical imbalance during a certain period is required.

Commercial balancing (e.g. cost allocation rather than punitive measures) can be done after the event and is a primary responsibility of the shippers.

We are of the opinion that the tools and instruments that are needed by downstream shippers to balance their gas portfolio should be provided by the market.

Measures and incentives provided by the TSO to shippers to ensure physical and commercial balance should be cost reflective rather than punitive and based on the principle that the parties who cause the imbalance bear the cost. For instance in a system with a daily balancing regime this could be done on the basis of volume and load factor within the day.

We agree that unplanned gas production restrictions make it infeasible to require every shipper to nominate exactly and to be in balance at all times.

The TSO should be a net consumer of services and not offer services other than are needed to fulfil its role as a residual system balancer. The TSO has access to commercially sensitive information which can not be available to normal market participants. The TSO should therefore not undertake any commercial activities in competition with other market participants.

## **Responses to the "key questions" raised by ERGEG**

Question (1): *Are there other features that should be reflected in a gas balancing regime to help ensure efficiency and to maintain safety and security of the system?*

Response: We support stability of the gas balancing regimes. The regimes should promote interoperability, and do not necessarily have to be similar.

Features that force links between shippers across entry-exit points should be avoided. Examples of such rules are pre-event shipper pairing and matching requirements, lesser-of-rules on nominations, and limitations to trading on the flange.

Question (2): *Should the incentives to balance become stronger the further away a shipper is from being in balance or are there are other ways of ensuring that shippers have appropriate incentives to minimise their imbalance positions? Should shippers be allowed to trade their*

*imbalance positions on an ex-post basis as a way of improving overall efficiency?*

Response: We support the observation made by ERGEG on page 18 of the discussion paper, "that in some instances the balancing period is too short – placing strain on the information systems supporting the balancing regime and unnecessarily increasing the risk to market participants – potentially creating a barrier to the development of competition".

A clear distinction should be made between the requirement to technically operate the system and the commercial framework to allocate imbalances post event.

We are of the opinion that incentives to balance should be cost reflective rather than punitive. The cash out prices should be consistent and simple to operate.

The balancing period should be designed such that the parties (e.g. shippers and TSOs) are able to manage their positions efficiently before a penalty is incurred.

The option of ex-post trading of imbalances should be available to shippers. This would generally reduce penalties, without giving shippers an incentive to go collectively short or long in the system. Ex-post trading of imbalance positions by shippers will also reduce the frequency and impact of re-nominations under upstream gas supply contracts, which has a positive effect on overall system efficiency.

Abuse of the balancing regime flexibilities and tolerances should be prevented by appropriate post event cost allocation mechanisms and licence requirements on shippers to ensure balancing of the system.

Question (3): *Does hourly balancing create any barriers to the development of competition?*

Response: From a producer point of view Shell would like to stress that many upstream production facilities (such as wells, sub sea installations, and upstream processing facilities) have minimum flow requirements and restrictions on ramp up /down rates. These facilities have not been designed to change production flows on a frequent basis. Doing so would jeopardise the safe and efficient operation, increase cost, and could ultimately have a negative impact on the recovery of hydrocarbons from the reservoirs.

The downstream balancing regime should therefore be designed to allow co-existence of the upstream operations and downstream balancing regimes. The balancing regime should have no negative impact on investments that support security of supply.

We agree that the market has the primary responsibility for gas balancing and that the TSO retains a residual system balancing role.

Question (4): *What information is required to ensure that gas balancing regimes operate effectively and efficiently and how often should this be provided? What is the best way of ensuring that this information is provided to all parties on a non-discriminatory basis?*

Response: To our opinion, a generic statement that all relevant information should be provided to *all parties* is not in line with the principle to give the market the primary responsibility for balancing.

Information is commercially sensitive and should only be exchanged between contract parties. The main contractual relations in the market are between buyers and sellers. Hence the main flow of information should take place between producers and shippers.

From a producers point of view we see that the TSO has a need for aggregated flow information per entry point. Producers and terminal operators already provide real time aggregate and forecast flow information to TSOs, allowing them to operate their systems safely and efficiently.

The TSO can make the overall physical network balance position, available to the shippers.

Producers can provide their contract parties on request and based on contractual agreements with the flow information on specific entry points and their entitlement under their supply agreements.

The TSO should refrain from making available commercially sensitive data or data that can be used to derive commercially sensitive information. It should be noted that even aggregate data can be commercially sensitive.

Question (5): *Should linepack (where technically feasible) be made available to shippers on a non-discriminatory basis to improve access to flexibility? Are there any other steps that could be taken to improve access to flexibility that would not impinge on the safety and security of the system?*

Response: The TSO should be a net consumer of services and not offer services other than are needed to fulfil its role as a residual system balancer. The TSO has access to commercially sensitive information, which cannot be available to normal market participants. Therefore the TSO should not undertake any commercial activities in competition with other market participants. The TSO should not market linepack.

Question (6): *Do differences between (neighbouring) gas balancing regimes distort or the incentives provided to market participants? If so, what degree of consistency would be appropriate to overcome these problems? Would there be any disadvantages from introducing more consistency in features of (neighbouring) gas balancing regimes? How could this consistency be facilitated – for example would legislation be required or could it be achieved through better co-operation between regulators and TSOs in different Member States?*

Response: Shell supports stability of the gas balancing regimes. The regimes should promote interoperability, and do not necessarily have to be the same.

Differences between (neighbouring) gas balancing regimes increase the administrative burden and may require additional risk management. The use of OBA's could mitigate some of the effects of these differences.

In most cases the various gas balancing regimes should be able to co-exist without any problems, as long as the approach taken by the TSOs is to technically operate the system based on best information available, of actual and forecast flows, and the cost allocation system is administrated post event.

As long as TSOs perform their residual balancing role efficiently there should be no need for additional legislation.

It is important that a greater level of consistency is facilitated through an appropriate and efficient process. While Shell considers that better interoperability between neighbouring gas balancing systems should be an objective, we do not consider that this requires introduction of more legislation.

Question (7): *Would cross-border (or international) balancing zones help facilitate the development of competition in gas across Europe? What technical, legal and practical issues would need to be overcome if cross-border balancing zones were introduced? What impact could cross border balancing zones have on the development of hub based trading and regional markets (see for example the recent ERGEG document on regional markets in electricity)?*

Response: Shell supports further interoperability of the gas balancing regimes across Europe. To us this has more priority than setting up cross-border balancing zones.

Question (8): *Would it be appropriate to increase the level of consistency between balancing rules for transit and transportation systems?*

Response: We would consider it appropriate to increase the level of consistency and transparency between balancing rules for transit and transportation systems. This does not however imply that balancing rules should be the same for transit and transportation systems.

Question (9): *Would the introduction of Operational Balancing Agreements (OBAs) between transit and transportation systems improve transparency on how the balancing regimes interact? If so, what should be included in the OBAs?*

Response: An OBA is a contract specifying the procedures two pipeline operators will use to manage the difference between the scheduled quantity and the measured quantity. The tool to manage these variances could be linepack, which would reduce the remaining flexibility for shippers in those systems. The balancing regime should be geared towards reducing the claim the OBA makes on linepack.

With respect to transparency and balancing period, an OBA requires the same approach as the pipeline system as a whole.

### **Comments on the suggested changes to the CEER gas balancing principles**

This section contains the Shell comments on the suggested changes to the existing CEER gas balancing principles. As a general comment we prefer the description of these principles to be clear and concise and not evolve in the direction of providing procedures for the implementation of these principles.

Principle 1 We agree with the proposed changes.

Principle 2 We agree with the proposed changes.

Principle 3 We agree with most of the proposed changes. We do not support the suggested change made in the second bullet to make linepack available to market participants.

The TSO should be a net consumer of services, and not offer services to individual parties in excess of its role as a residual system balancer.

Principle 4a We have no comments.

Principle 4b We agree with the proposed changes.

Principle 4c In the motivation "Reason for change" ERGEG mentions that the TSO should provide the necessary systems to facilitate efficient trade. We would like to note that this should be provided by an independent body like is the case with the APX in the UK.

Principle 5 The TSO should facilitate trading of imbalances, the actual trading systems should be operated by an independent body like is the case with the APX in the UK.

We agree that the use of tolerances should be minimised as far as possible. Some use of tolerances will continue to be appropriate in a market balancing system to reflect technical capabilities. Trading of imbalance positions should be promoted, rather than trading of tolerances.

Principle 6 We do not support the wording of the suggested change.

The level of information available to the TSO should not drive the level of information provided by the TSO to the market participants.

Information that is available from connected upstream supply sources is subject to commercial contracts. Shell would like to note that the commercial sensitivities and confidentiality of information should be respected.

Information that is needed by the TSO to manage the transport system should not automatically be provided to all shippers by the TSO. Where information is provided (such as actual and forecast flow measurement on an aggregate level) by connected upstream supply sources, to technically manage the transmission system, the main communication route usually is between the producer and the TSO.

The commercially sensitive nature of information should be respected and the TSO should take steps to prevent that such information is published or easily deductible from published information.

Principle 7 We agree with the proposed changes.

Principle 8 We see no need for this new principle and do not support its content.

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