

CMA's Energy Market Investigation

Response to provisional findings and the notice of possible remedies by Oil & Gas UK

Oil & Gas UK, the upstream industry association, is pleased to respond to the CMA's provisional findings report and notice of possible remedies published on 7 July. Our membership comprises more than 500 companies active in the UK offshore oil and gas sector, ranging from international oil and gas companies through independent operators and utilities with upstream subsidiaries to supply companies serving offshore operations. As producers of gas, many of our members are shippers on the National Transmission System (NTS) and are active on the NBP wholesale gas market. Our members' activities therefore straddle both the upstream, regulated by DECC and the new Oil and Gas Authority, and the downstream network regulated by Ofgem. As an association, we have recently followed closely the numerous modifications to the Uniform Network Code (UNC) arising from the EU Network Codes which affect GB network capacity trading arrangements and the wholesale gas market.

UK gas production stabilised in 2014 when indigenous sources provided half the gas entering the NTS. We expect the recent stabilisation of import dependence to last a few more years as upstream fiscal and regulatory changes support new investment in gas field development, even without the potential contribution of onshore shale gas in the 2020s.

We set out below some responses and observations which relate to proposed remedies 15 -18 concerning policy objectives and code governance. We offer no direct comments on the provisional findings report or the proposed remedies regarding the retail energy market.

Policy trade-offs and communication (Remedy 15)

We recognise that the trade-offs between supply security, affordability and decarbonisation are not articulated to the public in a clear, consistent and regular manner by government, Ofgem or supplier companies. The quality of the public debate over energy and climate policy has often suffered and been made worse by the lack of trust in the retail market. Some public sector entities, such as the Committee on Climate Change, have published useful analysis but such contributions are relatively few. Ex ante assessments of the impact of policies will continue to depend on their sensitivity to commodity price assumptions and ex post assessments will always suffer the problem of establishing an appropriate counter-factual basis for analysis. We do not see the need to create new institutions to assess and communicate the trade-offs in energy and climate policy. The primary responsibility for setting and communicating policy lies with DECC and the regulation of the downstream markets lies with Ofgem. It is for these two bodies together to address how any desired improvement should be made.

Ofgem's statutory duties and competition (Remedy 16)

We believe that making choices between competing policy objectives is properly a matter for government, not for an independent regulator whose original remit and expertise was competition and consumer protection. In our experience, Ofgem has appeared to lack the confidence and expertise in reconciling competing policy objectives that it has shown in earlier times when its sole responsibility was competition. We recognise the policy requirements and trade-offs are extremely

complex. At times, the demands of its new duties and the amendments to the UNC required by the EU Network Codes appear to have diverted Ofgem's attention from its original core duties. For example, its guidance on carbon cost assessment in the UNC Modification process has not been appropriate or well understood by those involved.

Competition is a means to an end (social welfare), not an end in itself. At this stage, we do not advocate simply stripping Ofgem of the new duties acquired under the Energy Act 2010 but a review of its duties and how effectively it discharges them may be appropriate.

Addressing DECC-Ofgem policy disagreements (Remedy 17)

We offer no comment on the proposed remedy for a new formal mechanism to resolve disputes between DECC and Ofgem on retail matters but wish to remark on another aspect of the DECC-Ofgem relationship.

The experience of UK gas producers and shippers in 2012-15 has more often been one of a failure of DECC and Ofgem jointly to consider issues at the upstream-downstream interface rather than disagreement between them. Important issues which affect the entire wholesale gas market have 'fallen down the regulatory crack' between DECC, responsible for the upstream, and Ofgem, responsible for the downstream. No longer does either DECC or Ofgem seem to have an appreciation of the entire UK gas chain and jointly they have found it difficult to re-create one.

This neglect of the integrity of the UK upstream-downstream interface has been most evident in the adoption of a series of UNC Modifications in gas to comply with EU Network Codes which will add to GB consumer costs but will confer no discernible benefit on GB consumers. The debacle surrounding the enforced change of the downstream Gas Day on 1 October 2015 (UNC Mod 461), which creates for the first time a barrier to trade between the UK upstream and the NBP, is just the most notable instance. On the development, adoption and implementation of the EU Network Codes in gas, there has indeed been a lack of transparent, informed assessment of the 'wider industry impacts' by DECC and Ofgem, to the likely detriment of wholesale market competition, liquidity and UK consumers.

The transfer of responsibility for the UK upstream from DECC to the new Oil and Gas Authority (OGA) and the incorporation in UK statute law of the obligation to maximise the economic recovery of UK oil and gas resources ('MER UK') will require much closer co-operation between upstream and downstream regulators. Achieving optimal recovery of remaining UK offshore gas resources from the highly mature North Sea will depend on non-discriminatory access to the downstream transmission network on fair and acceptable terms. We therefore recommend that Ofgem establish a close working relationship with the new OGA to ensure the 'regulatory crack' is properly filled.

Code governance and the code modification process (Remedy 18)

There seem to be notable differences between the practice of code administration in gas and electricity. Our comments in this section are based entirely on our experience of the gas Uniform Network Code (UNC) only, administered by the Joint Office of Transporters.

We are puzzled by the suggestion in Remedy 18a that code administration should become a 'licensable activity'. Activities which are licensed currently are commercial activities of shipper, supplier and transporter. Important though it is, code administration is not a commercial activity but

a function created by the obligation in existing licenses. The remedies 18a-18c are presented as a means of promoting 'innovation'. This is equally puzzling for those involved in UNC modifications since 2013 where the challenge for the gas industry and the code administrator since 2013 has been to keep up with the tide of new Regulations emanating from the EU. Compliance with EU law, not 'innovation' or 'keeping pace with market developments' has been the primary source of new UNC modifications since 2013.

On the questions of Ofgem's powers and influence in the process of code modification, we are not persuaded by the suggestion to grant Ofgem more powers (Remedy 18b) over developing implementing code changes. The UNC is essentially a contract between the transporter and shippers and these parties are the sole signatories. If Ofgem were to be granted more powers, a possible consequence is that in pursuing its policy objectives Ofgem may use the Code to affect transporter or shipper behaviour rather than the license modification route.

Moreover, Ofgem already has the power to introduce a 'significant code review' and in practice it can influence the timing and duration of the modification process through its consideration of new Mod proposals and its participation in industry workgroups. The excessive length of some recent UNC Mod processes, including those ostensibly intended to comply with new EU law, could have been addressed by earlier, decisive guidance from Ofgem as to the relevant economic and legal issues.

In our view, there are deficiencies in the current UNC modification process which should be addressed but they may not be amenable to easy solution. Smaller companies are often under-represented in working groups; industry data is too often held by the monopoly transporter and is not subject to proper independent scrutiny and workgroups sometimes lack the expertise to form a judgment on complex financial, legal and environmental questions. The consequence is that the code modification process is sometimes not effective, efficient or impartial. Some complex issues (such as network gas quality) have consequences far beyond the downstream networks and should, in our view, be referred to a wider industry policy body with access to external consultancy services to assist in the appraisal. Furthermore, the code modification process lacks coherence and any consistent direction as it responds in an *ad hoc* manner to initiatives from National Grid, shippers, Ofgem or EU regulations.

In Remedy 18c, it is proposed to appoint an 'independent code adjudicator' in cases of disputed code changes. This idea deserves further consideration since it may offer a solution to what we believe is another problem with current code modifications: the very limited right to challenge to Ofgem decisions to approve or reject a modification. At present, parties have a very limited period (15 working days) in which to request a judicial review or a referral to the CMA. Such reviews or referrals are costly and very resource-intensive, which acts as a high barrier to any challenge, even in the event of substantial financial loss. The creation of an alternative route to review Ofgem's decision, or taking the decision away from Ofgem and placing it with a well-resourced, independent adjudicator with extensive industry experience, is worthy of further consideration.

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