



12th April 2007

Hannah Cook
Regulatory Economist
Office of Gas and Electricity Markets
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Dear Hannah

BG Gas Services Limited Response to UNC Modification Proposal 104 Impact Assessment.

BG Gas Services Limited (“BG”) holds a shipper licence under the Gas Act. BG Gas Services is part of BG Group and sells gas on behalf of affiliate companies in the UK wholesale market. BG Group also has capacity rights and equity in the Dragon LNG terminal at Milford Haven in Wales. As stated in our responses to the Joint Office of Gas Transporters BG does not support the implementation of Modification Proposal 104. BG does not believe that the Impact Assessment shows sufficiently clearly that there would be a benefit to merit its implementation, nor does it show that the proposal meets “the relevant objectives”.

There are a number of weaknesses with Ofgem’s analysis which therefore question the value which Ofgem ascribes to implementation of the Modification Proposal.

Firstly, Ofgem fails to demonstrate that there is any benefit to the consumer of disclosure of daily LNG stock data. The methodology used in Appendix 3 is fundamentally flawed and the quantitative conclusion is misleading. The model looks at price behaviour in two different winter quarters (4Q05 and 4Q06) in which UK import infrastructure and supply and demand conditions were dramatically different. It purports to attach a financial value of disclosure of information. In our view, it does *not* provide any guidance at all on this question and indeed cannot be expected to do so. It would necessary to compare price behaviour in similar market conditions over a long period in two different cases, one with stock disclosure and the other without such disclosure – such a comparison is simply not feasible. In fact, what the Ofgem model addresses is the impact on prices in 2005 and 2006 of LNG flows through the Isle of Grain terminal, rather than being diverted elsewhere. It does not, and cannot, reveal the alleged impact on prices of the disclosure of information about the level of stocks at the Isle of Grain terminal. The UK gas market responds constantly and almost instantaneously to ‘real time’ changes in supply and demand flows, not to the ‘ex post’ publication of daily flow data.

Secondly, even if one accepts Ofgem’s approach, Ofgem has used artificial scenarios with which to model the benefits. Under the “No Information Scenario” Ofgem has assumed that market participants will presume that no gas will flow when LNG is diverted to other markets, and that therefore prices will be higher than when there is “full information”. However such an assumption is clearly unrealistic. As Ofgem has stated elsewhere in its report, Ofgem has

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modelled storage levels based on observable ship movements, information on flows from the Grain terminal, and assumptions about cargo sizes. Ofgem itself says that “the difference between the actual stock information and the modelled stock information was low”. If Ofgem can perform such modelling it is a reasonable assumption that market participants can do so, and may be doing so already. In this case, by using the “No information Scenario” Ofgem is clearly overstating the benefits of publishing the information. On Ofgem’s own calculation the benefits are already very low compared to the total value of the UK gas market (approximately £1 NPV per customer spread over 15 years based on Ofgem’s highest estimate of £20 million, or 40 pence per customer on what Ofgem considers the most likely outcome of £8 million NPV over 15 years). Reducing these benefits further makes them statistically insignificant.

There are other reasons to question the validity of the model in Appendix 3. It deals with a period 2005-06 when only one UK LNG regas terminal was in operation – by 2008 there will be four in operation and the behaviour of prices in response to changes at one terminal can reasonably be expected to change as the LNG and pipeline import infrastructure expands. Furthermore, the assumptions in the model appear arbitrary and there is no attempt to address the sensitivity of the alleged result to changes in these assumptions.

In addition to the comments above, BG has the following answers to your questions.

Question 1: Do you agree that, on the basis of observations this winter, the Isle of Grain LNG importation facility generally operates as a baseload source of gas supply?

We cannot comment for Isle of Grain but we would expect LNG terminals to operate as a function of the relationships between gas prices in various markets, the commercial positions of the shippers, and the physical requirements of the terminal. It is notable that in March 2007 Isle of Grain shippers diverted cargoes to other markets.

Question 2: Do you agree with the assumption that LNG importation facilities will operate similarly to storage following a diversion of LNG imports away from GB?

No. LNG import terminals have different physical characteristics from other storage facilities which impact on their levels of send out. The operation of the terminal will also depend on the contractual arrangements between the shippers and the terminal, and the shippers commercial positions, for example their expectations of future deliveries of LNG and gas prices.

Question 3: Do you agree that the provision of stock information regarding LNG importation facilities would allow market participants to make more informed forecasts of when LNG facilities would flow following a diversion of LNG imports away from GB, and that parties could then factor this into expectations of market price?

No, for the reason outlined in the answer to question 2. Also Question 3 assumes that other market participants shippers will make the same assumptions about future prices, both within the UK and elsewhere, and availability of LNG, as in an LNG terminal. A competitive traded market works by having sufficient liquidity and many buyers and sellers, not by all participants having access to all the same information.

Question 4: do you think that the estimated benefits obtained from our quantitative analysis are reasonable?

No. See comments above.

Question 5 : Do you think that the proposal would improve the economic and efficient operation of the market?

No. For further details see our comments on the Final Modification Report and our Response to the Modification Proposal consultation on 27th November 2006..

Question 6: Do you think that our assessment of contract negotiation required as a result of the proposal is fair?

It is not clear to which section this question refers.

Question 7: Do you think that the proposal would improve competition?

No. For further details see our comments on the Final Modification Report and our Response to the Modification Proposal consultation on 27th November 2006.

Question 8 : Do you think the proposal would positively benefit customers?

No. See our comments above.

Question 9: Do you agree with our assessment of the impact of the proposal on short and long term security of supply?

No comment.

Question 10: Do you think that our assessment of confidentiality and commercial sensitivities is fair?

No. If one accepts Ofgem's contention that LNG tank stocks are the same as storage (which BG and UK law does not support), it is not clear why LNG stocks should form a separate category of storage information from either medium or short term storage. Commercial sensitivities would be better protected if there was a greater degree of aggregation of all stocks.

Question 11: Do you agree that, given current information available, concerns regarding the commercial sensitivity of the information are largely mitigated?

No. There is a significant difference between other market participants knowing a player's position for certain, and making informed judgements. The latter involves risk for both sides, and is a normal part of operating in a traded market. The former skews the competitive playing field unfairly.

Question 12: Do you think that if the proposal were implemented prior to more than one LNG importation being operational this would be inconsistent with the intent of the proposal to publish aggregate stock information?

This simply highlights the poor drafting of the original Modification Proposal, a point which was made during Transmission Workstream and Modification Panel discussions. Rather than Ofgem deciding arbitrarily what the "intent" of the Proposal is, Ofgem should follow the lead of the Modification Panel which rejected the proposal unanimously.

Should you have any queries on the above please do not hesitate to contact me on ++ 44 118 929 3442.

Yours sincerely,

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