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12th April 2007
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BP welcomes the opportunity to comment on Ofgem's Impact Assessment (IA) regarding the publication of storage information at LNG importation facilities.

After reviewing the data presented in the impact assessment, BP's strong recommendation is that the modification proposal should be rejected. Our key concerns with the modification proposal are set out below.

Background

Uniform Network Code (UNC) modification proposal 104 was proposed by Energywatch on August 8, 2006 and is part of a wider campaign, beginning with UNC modification proposal 006, to improve data transparency for the wholesale gas market. The modification seeks to address a perceived information asymmetry between LNG importers and participants in the wider market by requiring National Grid to publish aggregate volumes of gas stocks of all LNG Importation Facilities (with the exception of Excelerate Energy operations)[1]. However, as the Grain LNG facility is the only LNG facility currently in operation and may be the only LNG import facility that provides stock data to National Grid, it appears that the modification is targeted directly at the Primary Shipper holding long term capacity Grain. This is especially troublesome as the Primary Shipper will be competing with other shippers at LNG importation facilities in the UK and Europe.

Ofgem has indicated its intention to accept the modification proposal, based on the following support and analysis:

1. The proposed modification, which impacts users of a legally separate facility connected to the NTS, falls within the scope of the Uniform Network Code and its modification process.
2. Release of aggregated LNG stock data will assist market participants in understanding LNG facility flexibility over a period when LNG supply is diverted or disrupted, thereby enabling parties to calibrate price expectations under certain circumstances;

[1] Ofgem states that the Excelerate LNG vessels are not captured within the definition of an "LNG importation facility" and would therefore not be covered by this UNC modification. Impact Assessment at p.9, note 19.

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3. Although LNG data is widely and publicly available, allowing market participants the ability to make accurate calculations of stock levels, Ofgem wish to remove this onerous burden by providing aggregate data;

4. Publication of LNG stock data will reduce "rumour" and "speculation" in the wholesale market which will reduce inefficient volatility;

5. The proposal will yield "material" benefits of £1.55 million to 19.95 million over the next 15 years, or approximately 2.3 pence per UK customer per year (using the medium case).

Economic benefits of the proposal

The benefits are immaterial and have been overstated by Ofgem because:

- Ofgem's assumption that disclosure of stock data will improve the ability to predict LNG usage patterns (and hence, prices) is flawed because LNG stock is not used in a similar fashion to gas storage facilities. For example, there are times when LNG stock cannot flow in response to high prices because it must be maintained to ensure the maintenance of the OM and heel gas before the next scheduled cargo delivery. There are times when it will flow even where prices are low (relative to other markets), for example in clearing the tanks to receive a cargo. Therefore, release of the data will add no further benefits to the market than that which is already publicly available.
- The benefits derived from this proposal have been attributed to all market participants. In practice any benefits would only be felt by customers who have chosen not to contract forward for gas supplies and therefore those who would be exposed to the daily spot price of gas, which is likely to be a much smaller number.
- The Isle of Grain is competing with all forms of supply and therefore it will only be the price setter in very limited circumstances.
- Modelling price savings over 15 years is not robust as prices in different years reflect substantially different demand levels.
- Ofgem has used the "no information" scenario as the base case, which gives rise to artificially inflated benefits, given that accurate information is currently in the public domain, or can be derived from published information.

Best Regulatory Practice

Security of supply and investment is influenced significantly by the stability of the regulatory environment. Failure to follow sound regulatory practice will have a negative impact on long and short term investment. Accordingly, BP is somewhat concerned with Ofgem's views expressed in paragraph 3.24 and 3.25 of the IA. Specifically, Ofgem seems to argue that regulatory decisions on proposals such as this modification proposal will have no impact on investment or supply security since investments and contractual arrangements are already in place. Although this approach may be accurate, BP does not believe that "bait and switch" regulatory practices are conducive to investment and supply security.

Best regulatory practice requires, amongst other things, that "regulatory activities should be transparent, accountable, proportionate, and consistent and targeted only at cases in which action is needed".[2] Approval of this proposal would be inconsistent with best regulatory practice for a number of reasons. First, Ofgem's own analysis demonstrates that the publicly available information is accurate. Moreover, further disclosure would not improve predictability as LNG stock levels are influenced by non-price factors. Secondly, the potential benefit, using Ofgem's flawed analysis, is immaterial. Finally, because it is highly likely that the modification cannot be implemented due to the lack of information from other LNG facilities, it seems wasteful to spend time on this proposal until Ofgem can ascertain the willingness of other facilities to provide stock data.

Legal position

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[2] Energy Act 2004, section 178.

In section 1.4 Ofgem refers to the fact that its initial legal view, as expressed in Ofgem's letter dated 07 September 06, was that the proposal did fall within the scope of UNC, but in the IA Ofgem does not confirm that this is, in fact, the final view reached by Ofgem or its reasoning for that final view.

We are somewhat surprised by this given the fundamental nature of the question whether the proposal falls within the UNC. In its letter of 7th September 2006, Ofgem maintains that the proposed modification falls within the UNC modification procedures due to the existence at one specific LNG facility, namely Isle of Grain, of limited operations margins (OM) support arrangements. We remain unclear how this principle can be extrapolated and applied to other LNG import facilities which, as far as we are aware, will not have OM obligations or any other contractual arrangements with National Grid. It seems arbitrary that similarly situated facilities (directly or indirectly connected to National Grid's system) are impacted differently by the UNC modification process simply because National Grid happens to posses certain information pursuant to an existing agreement or other arrangement. In other words, if National Grid has stock data, the facility is subject to the UNC process but if it does not, then the facility remains outside the scope of the UNC modification process. It would be useful if Ofgem could provide any further clarification on the legal aspects of this matter.

BP's detailed response to Ofgem's questions as set out in section 3 of the IA can be found in the Appendix to this letter.

We trust our response will be helpful to Ofgem in making its decision. Please feel free to give me a call on the above number if you have any questions on our response.

Yours sincerely

Fiona Lewis

Appendix

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

BP considers that the Isle of Grain facility cannot be generalised in this way especially on the basis of one winter. LNG operates in a highly liquid global market and will as far as possible, react to world prices and thus sail to the highest priced destination in accordance with forward prices at the time of diversion and also subject to a number of factors including operational restrictions. A number of slots at the Isle of Grain went unused in March due to the fact that the GB price was considerably lower than the Henry Hub price. This in itself demonstrates that LNG does not operate as a base-load facility when market prices dictate otherwise.

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?

Under normal conditions, the main economic driver at an LNG facility is to vacate the tanks ahead of future scheduled deliveries. It is only when slots are left unutilised that the users of the LNG facility can access the optionality around deliveries, which is less likely during peak market conditions**.** However, this flexibility is limited at the Isle Grain facility due to the OM obligation on the Primary Shipper. The Primary Shipper has an obligation to manage the OM gas requirement at all times and therefore when there are no cargoes in the schedule, the Primary Shipper has to ensure that there is enough gas in tank to cover the OM gas requirement whilst taking into account the level of minimum send out and any related operational issues. Restrictions on the utilisation of flexibility are significant. This alone ensures that it is much harder to compare the level of flexibility of storage utilisation to the flexibility of the Grain facility. Due to these practical issues, release of stock data will not enhance the predictability of LNG usage.

Although the Isle of Grain is capable of an annual throughput of 4.4 bcm, it is unable to store 4.4 bcm at all times in its storage tanks. LNG must be sent out onto the NTS to enable another ship to enter the facility due to the amount of headroom available. Grain is also unable to cycle gas and therefore it means that it again has less flexibility than a conventional storage site.

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?**

First, Ofgem has already accepted in its IA that the tank stock information can be derived from information that is already in the public domain. BP would also like to point out that the size of cargoes coming into a LNG facility is often reported in the Trade Press and can also be found via the internet. Market participants are therefore clearly able to predict the tank stocks to a reasonable degree of accuracy. The modification proposal merely transfers the risk and burden of providing this information away from the parties requesting it.

Second, the publication of stocks does not indicate whether the stocks are available to the spot market or whether the LNG has been pre-sold and therefore the price of the LNG has already been factored into the market.

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

We consider that the figures presented in the IA are misleading due in part to the underlying assumptions that Ofgem have generated. In paragraph 3.14 Ofgem indicates that the benefits have been calculated by comparing the scenarios of ‘no information’ and ‘all information’ being available to the market. BP is of the view that it is inappropriate to use the ‘no information’ scenario as the base case because it does not accurately reflect the status quo. The base case should, in our view, be calculated against the level of information that is currently available to the market, which as Ofgem points out in paragraph 2.15, enables the market to estimate the accuracy of the tank stock levels within 10% for 72% of the time. Given that Ofgem’s model is relatively unsophisticated; market participants should be able to forecast the tank stock levels with a greater degree of accuracy. BP considers that this base case assumption invalidates the benefits claimed by Ofgem, many of which are actually already being enjoyed by market participants and should not therefore be deemed an added benefit which would result from the implementation of this proposal. Moreover, sound regulatory practice dictates that Ofgem should not intervene where the market is clearly working to provide reliable information.

Ofgem indicates that the benefits have been calculated against a 15 year period. Whilst this serves to make the headline ‘benefits’ number more ‘eye catching’ we are surprised that Ofgem consider such a timescale can realistically be utilised for its analysis. It would seem impossible to say that these benefits will definitely continue to be accrued over 15 years given that the gas market is unlikely to remain static over this period of time.

BP also considers that Ofgem has overstated the benefits by employing the method used in Appendix 3. Ofgem's model assumes that if LNG was unavailable to the market, the market would then expect the next highest price source of gas in the merit order to be delivered to the market and this would raise the price accordingly. Ofgem has assumed that all market participants would be affected by the reduction in LNG from Grain. However, BP is of the view that the benefits would only potentially be felt by those large customers who have not contracted forward for their gas and therefore have chosen to be exposed to the on the day spot price, which would be a very small proportion of the market. Therefore BP considers the benefits have been overstated by not taking this into account.

Under Ofgem's "no information" scenario, the analysis attempts to evaluate the difference in market prices, and therefore increase in economic rent, that might be expected if LNG imports were diverted from the UK market. While there are obvious difficulties in extrapolating the relationship between historical prices and fundamentals our biggest concern is the implicit assumption that the lack of formally published LNG tank stock will have the same impact on prices as the supply not turning up.

From a supply perspective, the owners of the gas in tank still face very clear economic incentives, subject to physical, commercial and operational constraints, to send out the gas on the highest price days and therefore the modification proposal does not imply any changes to physical supply. Moreover, given these clear economic incentives it also follows that the lack of formal tank inventory information will not unduly increase the uncertainty around supply which reduces the possibility of a higher convenience yield being built into prompt prices. As such, we believe it's difficult to argue the consumer benefits specified in the report.

Once the actual benefits are broken down, it becomes clear that the stated benefits have been artificially inflated; true benefits will be much lower and could even represent a net cost to the industry.

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

Tank stock information at the Isle of Grain is such a small element of the supply market and as Ofgem states the information can already be approximated to a level very close to the actual stock levels. Therefore, BP is of the view that based on that assumption this proposal would be unlikely to improve the economic and efficient operation of the market from the status quo. BP considers that this proposal will merely represent a transfer cost from the market and customers to National Grid and the Primary Shipper, it will not provide any discernable benefits and could even as suggested above mislead market participants by allowing customers to consider that all volumes of LNG flowing from Grain would be available for spot market purchases. As we have stated previously, this would not be the case if the volumes of gas have already been pre-sold into the market. Therefore, customers could make purchasing decisions based on incorrect assumptions, which would worsen the economic and efficient operation of the market.

The impact of disclosing LNG stock levels is extremely minute, but if it is deemed that a benefit exists, then disclosure of other de minimus data will be warranted.

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

N/A, there is no reference to contract renegotiation in the IA.

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

No. Competition has already resulted in the dissemination of LNG data, which provides speculators and suppliers the ability to form judgements on price movements, supply and demand. There is no need for Ofgem to regulate to improve the data that the market already provides, especially as the data will not yield any definitive information about the Joint Shipper's intention to sell LNG stock into the market.

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

No, this has been addressed in question 5**.**

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

BP is of the view that this modification proposal, in combination with other recent regulatory decisions, may hamper future investment in GB. This proposal serves as another example of Ofgem's tendency to approve modification proposals relating to minor issues that are already handled by the unregulated market.

BP is of the view that this proposal would not increase security of supply by allowing customers to make more informed purchasing decisions. BP struggles to see how knowing how much is in the tanks at Grain, data which represents only one small element of a much larger overall supply picture comprised of numerous elements and variables, would help customers make better purchasing decisions. This proposal would, in BP's view, only have the potential to impede security of supply by potentially placing the UK LNG users in a disadvantaged position compared to their counterparties elsewhere, such that LNG spot cargoes could, all other things being equal, chose to go to other markets outside the UK which could lead to security of supply problems in the UK, particularly in the future as LNG becomes a greater proportion of the UK's gas supply.

BP is also of the view that approval of this modification proposal could reduce the incentives on GB shippers to provide OM gas to National Grid, due to the fact that if another LNG facility offered the OM service to National Grid, they would need to provide tank stock data to National Grid and will therefore be caught under the legal interpretation of this proposal, in that any information that National Grid holds could be published via a UNC modification proposal. If this occurs, it would have the affect of reducing the long and short term security of supply in the GB market.

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

BP welcomes Ofgem's statement concerning its view that individual commercial positions should be protected, and therefore BP supports the concept in 3.34 that should Ofgem approve the proposal, it would only be implemented once suitable aggregation could be put in place. According to the principles enshrined in European "Guidelines for good practice" at least three parties is required as a minimum before publication is required. If this proposal were to be approved and implemented before the other LNG importation facilities are in place, BP considers that it would be further commercially exposed, especially in the charter market and the LNG spot market. The charter market is illiquid and at times the LNG spot market is too and thus it can be hard to source LNG tankers and LNG stocks. If tank stock information was made available to the market then the market would be able to calculate when the Joint Shipper at Grain is approaching the volume of gas that must remain in tank for OM gas purposes. If this occurs the Primary Shipper could become a distressed buyer both in the charter market and the spot market. This could at times of shortness in both these markets cause vast commercial exposure.

BP also considers that this information could be misleading. If for example, a cargo sailed to Grain on day D and the subsequent slots were unused, the market would know the level of stock in tank and therefore would know how much LNG remained in the Isle of Grain. If the market, via the trade press or by any other means discovered a ship had left a LNG producing country heading for Grain, the market would realise that the stock level at Grain would need to be run down and the subsequent LNG sold to the market ahead of the new cargo unloading its LNG. The market could assume that this gas released to the NTS will be spot gas and would therefore have the effect of bolstering the supply picture and reducing the price pressures. However, this may not always be the case as highlighted in the answer to Question 3. The Joint shipper may have already sold forwards the volumes remaining in tank and therefore this gas would not help large customers make better on the day purchasing decisions because these volumes of gas would not affect the spot gas volumes on the day and therefore will not represent an increase in the actual supply.

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

No, see above.

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

The legal position as per Ofgem's letter dated 7th September 2006 is questionable. According to the Authority the OM information is already made available to National Grid. However, other LNG terminals (and indeed phase 2 of Grain) may not have OM publication requirements. It is therefore, doubtful whether this modification proposal can actually be enforced at other LNG terminals, thereby giving rise to discriminatory treatment of LNG Terminal Operators and their users.

Ofgem has stated in the past that, hypothetically it may be economic and efficient for NG to hold tank stock information at other LNG import facilities to help it run its National Transmission System in an economic and efficient manner, however, in the Transmission Workstream on 5th October 2006, NG stated that it did not consider that this information is necessary in order for them to operate the system efficiently. BP would be interested therefore, to understand how these positions can be reconciled.

BP considers that it would be inefficient regulation to implement a proposal where there is a real probability that it can never be operated in practice. For data to be made available at other LNG import facilities when they are fully operational is dependant on whether (a) there is a requirement for OM gas at those facilities and if so (b) whether capacity holders bid to provide it. BP is of the view that there is a compelling argument to reject this modification proposal. In simple terms there is a clear risk that if this proposal was implemented costs would be incurred by the industry but the benefits would never be delivered. If at some point in the future, National Grid receives tank stock data from all operational LNG importation facilities then this proposal, if deemed important, could be re-raised.