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UNC 104 Regulatory Impact Assessment

Dear Emma,

Thank you for the opportunity to comment on the above Regulatory Impact Assessment. ExxonMobil International Limited is responding on behalf of its shipping entity ExxonMobil Gas Marketing Europe Limited. Given the nature of the proposal to which this impact assessment relates we have also sought and incorporated views from the South Hook LNG Terminal Company Ltd (owner and operator of the South Hook LNG Import terminal currently under construction) and the South Hook Gas Company Ltd (the LNG importer) in which ExxonMobil companies have an interest.

Background

In our response to the Draft Modification Report we endeavoured to explain our position as follows:

(i) The quantity of OM LNG "storage" sold by the joint shipper at Grain to NGG is the <u>only</u> quantity that should be considered comparable to a dry gas storage service
(ii) We did not believe that it was clear in the 0104 proposal that "aggregation" referred to aggregation across all LNG terminals
(iii) Even if the OM part of the Grain inventory might be published, it could only be reported as part of an aggregate with other dry gas storage inventory (consistent with ERGEG guidelines)

It was our view that the drafting of the modification proposal was imprecise and unclear, appearing to ignore the distinctions between dry gas storage and LNG import terminals evident in the Gas Act legislation, and failing to acknowledge ERGEG guidelines in relation to aggregation. Hence we argued the proposal should be rejected in its entirety, whilst indicating that it might be easier to support a proposal that was clearly limited to the OM margins element of inventory (aggregated with similar inventory elements sold as part of storage service arrangement).

We urge Ofgem to step back and reconsider their approach to this particular transparency item. In the meanwhile below please find specific comments in relation to the questions raised under the RIA. .

The RIA Consultation

The upper value of the net benefit that Ofgem assesses (range £1.6 – 20M NPV 6.25) is very small compared to the £100 billion (order of magnitude) present value of gas to be purchased over the same fifteen year period.

The size or indeed the existence of a net benefit could be challenged as follows:

1. The range of benefits would be smaller if measured as **an increment** to the benefit from information already provided by the market (and which Ofgem admits exists in so far as they have made use of this to estimate inventory).

2. The range of costs would be bigger than those simply assessed for NGG; additional costs would be those incurred by companies both providing and handling the additional data. With so many market participants it is not difficult to envisage how total market costs could be a higher by a factor of ten or more.

3. The benefit assessed may be different and potentially negative if measured over a longer reference period than simply Q4 2006.

1. **<u>Do you agree, on the basis of observations this Winter, the Isle of Grain LNG importation facility generally operates as a base load source of gas supply?</u>**

   We are not entirely sure that we understand the relevance of this question. Where the send out rate from any LNG regasification facility remains relatively flat over any period it could be considered that the pattern of sendout is "base load" over that period.

   It is not possible to predict future diversion patterns (in or out) nor is it possible to predict whether this would result in a change in the pattern of sendout from a broadly flat sendout.

2. **<u>Do you agree with the assumption that LNG importation facilities will operate similarly to storage following a diversion of LNG imports away from GB?</u>**

   No, that is Ofgem's assumption. There is little similarity between a dry gas "storage" facility and an LNG importation facility. The services are mostly different and the points of contractual control on "injection" and "withdrawal" can be wholly different. The facilities are treated differently in all of the relevant legislation, but Ofgem continues to ignore this, and no explanation is given.

The only similarity between LNG and storage facilities occurs where a storage service has been contracted. Such a storage service appears to exist between the joint shipper at Grain and NGG for the purposes of OM provision. This affects only a part of the inventory in store and therefore only that part of the inventory can be compared with storage.

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?**

The provision of stock information will simply allow market participants the opportunity to speculate in a different way on when LNG will be regasified and when or whether there will be further diversion (in or out).

It is a different shade of imperfect and potentially misleading information. We doubt whether any benefit can be imputed from the inclusion of stock information when the more significant variables (90 day indicative plan, tanker movements, relative forward market prices etc) may be changing.

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

The benefit is insignificant in relation to market value, whilst the modelling assumptions are significant ones.

As commented on above there is considerable uncertainty over the quantitative assessment.

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

No, in our view the benefit at best is tiny and only incremental compared to the information being delivered by the market.

Any assertion that the proposal would improve the economic and efficient operation of the market relies almost entirely on Ofgem's assumption that any intervention to increase the amount of common information between market parties, however small the benefit assessed, must be a step towards a more efficient market.

Ofgem has not considered whether the intervention might actually be less efficient than the alternative of allowing the market to determine and furnish more valuable information under normal evolution.

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

We would ask Ofgem whether they would consider it reasonable to argue that their assessed benefit was significant enough to even risk forcing parties to renegotiate.

7. Do you agree that the proposal would improve competition?

We would judge it more likely that the proposal will be to the detriment of competition in the upstream market for production and supply of gas (including LNG).

8. Do you think the proposal would positively benefit customers?

Ofgem argues in 3.12:

"If information on storage stocks were available, it would be possible for market participants to build this flexibility into their expectations of price. Given the knowledge of this additional system flexibility, as well as their understanding of forecast levels of demand, it would be possible to make informed projections regarding the likely time that the facility operator would choose to flow gas onto the NTS. Parties would therefore have a more informed understanding of available gas supplies over the period that LNG supplies were diverted from GB and could take better informed views regarding the likely evolution of prices over this period."

In the first place it will not be the facility operator choosing to flow gas, rather it will be either the buyer or the seller who elects what gas to flow according to the terms of the gas supply and purchase agreement.

The pattern of gas flow ex LNG terminal under a seller's nomination contract may be different to that exercised under a buyer's nomination arrangement. In the case of LNG, it will normally be the seller (LNG importer) who is making nominations as the primary interest will relate to upstream production or shipping considerations. In circumstances where an LNG capacity holder happens to be in a position to offer storage services to a buyer, then it is more likely that the pattern of gas nominations under such a contract will reflect wholesale market drivers.

Finally, we believe that a party's assessment of supply availability and price will be mostly informed by forward market prices. Where further detail is sought, it seems to us that the more valuable detail will come from the market itself in the form of daily reports of LNG tanker movements and diversion announcements such as those that would be apparent from a terminal's "use it or lose it" arrangements via the associated bulletin board.

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

Ofgem argues in 3.15 "No Information Scenario" that, in the absence of LNG stock data, market participants will discount any potential system flexibility from the relevant terminal and presume that no LNG will flow for the duration of diversion of LNG imports, and that prices will respond accordingly.

Whilst understanding why Ofgem would make this premise, we think it far more likely that market participants will make forward assessments using: relative market prices to establish the likelihood of LNG imports or diversions and the likely requirement for LNG imports in aggregate; information on LNG tanker movements; the recent level of actual LNG imports and the recent pattern of gas flows ex terminal.

10. **<u>Do you think that our assessment of confidentiality and commercial sensitivities associated with the proposal is fair?</u>**

LNG stock in tank does represent potentially commercially sensitive information in certain markets and in certain operating contexts; the question is whether Ofgem believes that it has enough justification under the terms of better regulation to intervene in the market to secure daily publication of LNG inventory.

11. **<u>Do you agree that, given current information available, concerns regarding the commercial sensitivity of the information are largely mitigated?</u>**

It will be a part of the normal evolution and functioning of the market that global LNG tanker movements will be increasingly monitored and reported. In our view the current information available is adequate for the market at this stage and as monitoring and reporting becomes more sophisticated with increased dependency on imports so participants will be enabled to make increasingly informed assessments. Markets tend to work in a way that enables discovery of relevant information for its proper functioning. At this juncture, the production and supply market at least does not appear to consider that stock levels are a critical information component.

12. **<u>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?</u>**

As mentioned already we believe that, in the case of Grain, the only element of LNG inventory which can be legitimately considered for publication is that which relates to the quantities held as Operating Margins under the joint shipper agreement with NGG.

If you require clarification of any of the points we have raised in this response, please do not hesitate to contact me.

Yours sincerely

Ian Trickle