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| Modification proposal: | Uniform Network Code (UNC) 104: 3rd Party Proposal: Storage Information at LNG Importation Facilities | | |
| Draft decision: | The Authority ¹ is minded to direct that this proposal be made ² | | |
| Target audience: | The Joint Office, Parties to the UNC and other interested parties | | |
| Date of publication: | 6 July 2007 | Implementation Date: | |

Background to the modification proposal

A number of recent rule changes have been proposed that have sought to improve transparency and market operation by releasing more physical supply information to the wider GB wholesale gas market. Arguably the most significant of these was energywatch's UNC modification proposal 006 (Modification 006),³ that brought about the release of near to real time information regarding flows of gas coming onto the National Transmission System (NTS).

This letter considers UNC modification proposal 104 (Modification 104) that if implemented would require the publication of the amount of Liquefied Natural Gas (LNG) in store at LNG importation facilities.

The modification proposal

Modification 104 was raised by energywatch, the consumer watchdog, in August 2006. Modification 104 seeks the daily publication of data showing the aggregate volume of LNG stocks across all LNG importation facilities held at 05:59 (the end of the gas day). It is proposed that the information be published on National Grid's information exchange website by 16:00 on the following gas day (a lag of 10 hours and 1 minute).

Energywatch requested urgent status in order that Modification 104 could be implemented simultaneously with Modification 006. We rejected energywatch's application for urgency on the basis that Modification 104 did not appear to be linked to a relevant date related event.

Energywatch considers that Modification 104 would better facilitate the achievement of relevant objectives (a), (c) and (d) as set out on Standard Special Condition A11 (1) of the Gas Transporters Licence as follows:

In respect of Relevant Objective (a) energywatch considered that the modification would further the efficient and economic operation of the pipe-line system to which this licence relates. Modification 104 would provide shippers with the appropriate level of information to enable them to better forecast demand and thus make the appropriate trading decisions to balance their portfolio, with associated physical actions, resulting in an improved balance of the system as a whole.

¹ The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

² This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.

³ Modification 006 was implemented on 3 October 2006. In a bid to increase market efficiency it required National Grid Gas NTS Plc to publish the volume of gas supplied to each eligible sub-terminal of the NGG NTS transportation network close to real time. UNC modification proposals, modification reports and representations can be viewed on the joint Office of Gas Transporters' website at www.gasgovernance.com.

In respect of Relevant Objective (c) energywatch considered that so far as is consistent with sub-paragraphs (a) and (b), the modification would further the efficient discharge of the licensee's obligations under this licence. With respect to security of supply, Modification 104 would assist shippers in better forecasting demand, enabling them to make more efficient purchasing decisions, consequently reducing price volatility and facilitating security of supply.

In respect of Relevant Objective (d) energywatch considered that the modification would further the securing of effective competition (i) between relevant shippers and (ii) between relevant suppliers. Modification 104 would provide a level playing field where all shipper/suppliers have the same information available to them, provided through an established, consistent and transparent basis.

UNC Panel⁴ recommendation

Modification 104 was discussed at the UNC Modification Panel (the Panel) meeting on 21 December 2006. At that meeting, the Panel voted unanimously against implementation of Modification 104.

Impact Assessment

In March 2007, Ofgem published and invited responses to its Impact Assessment (IA) regarding Modification 104. In its IA, Ofgem indicated that it was minded to approve Modification 104 on the basis that we considered it would further the relevant objectives of the UNC.

Ofgem Open letters

On 7 September 2006 and 18 May 2007, Ofgem issued open letters in relation to Modification 104. Three main issues were covered in these letters:

- scope of the UNC with regard to Modification 104;
- timing of the release of information; and
- the "aggregate physical LNG in store".

Each of these issues is discussed in more detail in the following section.

Scope of the UNC with regard to Modification 104

Both open letters outlined the Authority's views on whether Modification 104 was within the scope of the UNC. We explained in both letters why we think that Modification 104 is within the scope of the UNC.

The scope of the UNC is determined under Standard Special Condition A11 of NGG NTS's gas transporters licence. NGG NTS must establish "transportation arrangements" pursuant to the UNC which (amongst other objectives) facilitate the efficient and economic operation of the NTS.⁵ The UNC must set out the terms of "transportation arrangements" established by NGG NTS and other relevant gas transporters to the extent that such terms are common, or are not in conflict, between relevant gas transporters.⁶

Standard Special Condition A3(1) defines "transportation arrangements". This term means arrangements whereby gas shippers and transporters may have gas introduced into, conveyed by means of and taken out of the NTS. In fact, it is clear that the transportation

⁴ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

⁵ Standard Special Condition A11(1).

⁶ Standard Special Condition A11(6).

arrangements set out in the UNC already extend to matters concerning LNG importation facilities.⁷

Modification 104 refers to “LNG Importation Facility”. The definition of an LNG Importation Facility in the UNC itself (i.e. the facility to which the modification proposal as drafted will relate) specifically includes LNG in store at such facilities. It states that:

an “LNG Importation Facility” is a facility:

- (i) which is directly connected to the Total System;*
- (ii) whose principal purpose is the receipt of liquefied gas from a sea going vessel, the storage of such liquefied gas and the regasification of such gas for delivery to the Total System;*
- (iii) from which stored gas may be delivered to the Total System whether or not gas withdrawn from such storage may also be delivered other than to the Total System.⁸*

The definition of “LNG import facility” contained in section 19E of the Gas Act 1986 is not relevant for the purposes of Modification 104, or more generally for determining the potential scope of the UNC.

In today’s markets, the LNG in store at LNG Importation Facilities will be regasified and introduced into the NTS (although, for the avoidance of doubt, it is only important to the relevant objectives of the UNC – in particular the economic and efficient operation of the pipe-line system and the security of effective competition – that it is *available* for regasification and introduction to the system).⁹ LNG Importation Facilities will therefore have arrangements in place for introducing gas into the NTS. It is our view that these arrangements constitute part of the transportation arrangements with respect to the GB gas system and so are within the scope of the range of matters that may be dealt with by the UNC.

Timing of the release of information

The legal drafting for Modification 104 is as follows:

| Data | Timing | Format | Presentation | Disclosure |
|---|----------------------------|---------------|---------------------|-------------------|
| The aggregate physical LNG in store (in kWh) at LNG Importation Facilities at 05:59 hours on the Preceding Gas Flow Day | By 16:00 hours on each Day | Tabular | Viewable | Public |

Some respondents to the IA assumed there would be a 34 hour and 1 minute lag in publication.

For the avoidance of doubt, the Authority is of the view that it is clear that the above legal drafting would result in the submission of aggregate LNG Importation Facility stocks at 05:59 daily to National Grid for publication 10 hours and 1 minute later at 16:00 the following gas day. This was explained in our open letter of 18 May 2007.

⁷ See for example, UNC TPD Sections K and R

⁸ UNC TPD R1.2.1(f)

⁹ It is noted that some LNG stocks will be held for the operation of the LNG Importation facility, and some stocks may be exported onto the local distribution network.

We published a second open letter to clarify this point. No respondents to that letter stated that they had, on the basis of this clarification, altered their views in relation to commercial sensitivity and confidentiality issues.

The "aggregate physical LNG in store"

Our open letter of 18 May 2007 also sought to clarify our interpretation of the word "aggregate" in the legal text. Responses to our IA suggested that this issue had been confused with the discussion on the potential exposure of the commercial position of the joint shipper operating at the Isle of Grain LNG importation facility (Grain).

Our open letter explained that Ofgem does not consider that the *necessary intent* of the proposal is to delay implementation until further LNG importation facilities have begun operation. The intent of the proposal is to allow greater market transparency irrespective of the number of LNG importation facilities. Therefore, we do not consider that the proposal *necessarily* requires more than one LNG importation facility to be operational prior to implementation.

The Authority's draft decision

Given the particular circumstances of this case, the Authority considers it appropriate to publish a draft decision in relation to the implementation of Modification 104. Industry participants have expressed the view that Modification 104 and Ofgem's IA were not clear in some respects. Certain participants also thought that Ofgem's open letter of 18 May 2007 contradicted statements made in its IA. We have therefore decided to set out in full in this letter our current views in order to provide clarification in this respect.

The Authority has considered the issues raised by Modification 104 and the Final Modification Report (FMR) dated 22 December 2006. The Authority has also considered and taken into account the responses to the Joint Office's consultation on the modification proposal which are attached to the FMR, and responses to the IA and the May open letter. We have also considered the release of this information in accordance with the Ofgem Guidance Document: Information release under Gas Transporters Licence Standard Special Condition A7, published in June 2005.¹⁰

The Authority is currently of the view that:

1. the implementation of Modification 104 would better facilitate the achievement of the relevant objectives of the UNC;¹¹ and
2. directing that Modification 104 be made is consistent with the Authority's principal objective and statutory duties.¹²

Reasons for the Authority's current view

Ofgem considers that Modification 104 impacts on the facilitation of relevant objectives (a) and (d) of the UNC most significantly. We have set out below why we believe Modification 104 would better facilitate the achievement of these objectives.

¹⁰ Available from the Ofgem website www.ofgem.gov.uk.

¹¹ As set out in Standard Special Condition A11(1) of the Gas Transporters Licence.

¹² The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Gas Act 1986.

Relevant objective (a) – the efficient and economic operation of the pipeline system to which this licence relates

Information transparency

Feedback received since the implementation of Modification 006 has demonstrated to Ofgem the value of removing information asymmetries in the market.

Respondents opposed to Modification 104 have suggested that whilst they are in favour of information transparency, in this instance the information released would be harmful to some parties. We discuss this issue further in the following section.

Those in favour of Modification 104 would welcome the release of this information and consider the release of this data would facilitate the provision of a level playing field between market participants. In particular, one respondent considered that increased market information and data transparency would help consumers understand the market and therefore aid the ability to make more informed forecasts. They also said that this information will allow market participants to factor the diversion of LNG imports away from GB into their market price expectations.

We think that transparent information is important to the effective functioning of the competitive gas market. Access to information with a greater degree of clarity and certainty will allow parties to better understand the functioning of the market and allow better informed commercial decisions to be made. Taking into consideration respondents' views we remain of the view that Modification 104 is beneficial in this respect when compared with the current baseline.

Economic signals

In addition to removing information asymmetries, Modification 006 has provided participants with a much clearer picture of the physical gas supply position, enabling them to make more efficient decisions in optimising their portfolios. With wholesale prices set correspondingly at more efficient levels, this ultimately translates into benefits for customers. The argument that Modification 104 improves economic signals is simply an extension of the case for Modification 006.

Although a number of respondents had argued that LNG stocks should be seen as simply a part of a production chain in the re-gasification process, we reasoned in the IA that this holds true only under "baseload" operation, with the facilities operating continuously at full capacity. As soon as there is an interruption to the sequence of incoming shipments (due, for example, to cargos being diverted to higher priced markets), the rational strategy for the shipper is to use the remaining LNG in stock in a similar way to a withdrawal-only storage facility. As such, during these periods the information on the stock level is as relevant to the overall physical supply position as that on inventory for storage facilities already made available through Modification 006.

We used modelling in the IA to quantify this benefit, which we estimated at between £1.55m and £19.55m over a 15 year period. Some respondents suggested that these results were over-stated, and that any benefits derived from the additional clarity and reliability of this information could only be extended to large customers exposed to the spot market.

For simplicity and clarity, we compared a situation in which the market has no knowledge of LNG import stock levels to one in which that information is made fully available. In practice, as we made clear, participants are currently in a position to make a reasonable estimation of stock levels based on other available data. Compared to this baseline, the incremental benefit is clearly smaller. However, there are a number of reasons why this does not change our view on the merits of Modification 104:

- (a) any improvement in the accuracy of information available to market participants will still result in a benefit (and implementation costs, discussed below, are very low);
- (b) providing this information through the UNC gives participants a much higher level of assurance of continued, timely and reliable access to the data;
- (c) costs incurred by participants in conducting the data monitoring and analysis currently required to estimate stock levels will be reduced; and
- (d) the benefits were evaluated based on the stock capacity at the existing Grain facility, and they will increase significantly as other facilities are commissioned¹³.

Given these reasons, we consider that, whilst a reasonable estimate of the stock levels at LNG terminals can be made using other currently available information, Modification 104 will better facilitate the relevant objectives.

Other respondents commented that the benefits outlined in the IA are insignificant when compared to the size of the market. However, the Authority must assess modifications to the UNC on the basis of whether they better facilitate the relevant objectives of the UNC, and in this case, even when the costs of implementation have been taken into account, we do consider that the proposal better facilitates those objectives.

Some respondents noted that the information could be misleading, as there may be other factors (such as contractual commitments) that affect the withdrawal decisions of shippers with LNG in stock and therefore stock levels do not provide an understanding of whether gas will flow. Whilst we recognise that this may be the case, as with any data, it is up to participants to determine how they best utilise the information that would be provided. However, in this instance, we consider that the stock levels do provide an indication of the availability of LNG for regasification and, therefore, the ability, or not, for gas to flow.

NGG's role as residual balancer

We continue to support the view put forward by energywatch that there is scope for the provision of this information to reduce NGG's role as residual balancer with respect to the gas market. As discussed in the IA the provision of more accurate information will improve market players' understanding of supply fundamentals allowing them to make better informed decisions and balance their own positions more effectively, thus reducing National Grid's residual balancer role.

Market Volatility

In the IA we outlined why we believe that during periods of diversions of LNG to other markets accurate stock level information will allow market participants to understand the supply position with greater certainty, thereby reducing potentially inefficient price volatility in the market.

Respondents opposed to the proposal suggested that volatility could be inadvertently increased as a result of market participants misunderstanding the information released. Although we recognise the potential for market volatility to increase, we think decisions taken by market participants based on actual market data rather than on inaccurate data or on market rumours are more likely to lead to efficient decisions and therefore consider the publication of this data will help to better facilitate relevant objective (a).

Relevant Objective (d) – so far as is consistent with relevant sub paragraphs a to c the securing of effective competition between shippers, suppliers and DNs

Competition

As was the case for Modification 006, by providing market participants with equal access to information we believe Modification 104 will promote effective competition. Whilst we

¹³ As we noted in the IA, there will be uncertainty in modelling multiple facilities using aggregate stock levels.

recognise that this information alone will not provide market participants with a full understanding of the market, accurate LNG stock information will contribute towards an enhanced understanding of the supply situation particularly when LNG is diverted to other markets.

Commercial sensitivity of the information

Respondents that are opposed to the implementation of Modification 104 have raised concerns that the release of information would expose the commercial position of the joint shipper at Grain and that this would be discriminatory.

One respondent considered that the Primary Capacity holders at Grain would be greatly disadvantaged in the short term because Grain is the only facility in operation this winter, and in the long term due to the fact that this information is not planned to be published at any of the other LNG import facilities. Further, the respondent argued that if the market was aware of this information at Grain then the Primary Shipper could become a distressed buyer both in the charter market and the spot market.

We consider that the commercial confidentiality concerns are very limited for two reasons. First, as we discussed in the IA, and as noted by respondents, it is already possible to derive a reasonable estimation for stock levels at the Grain facility on the basis of currently available information. Second, even if the physical stock position was accurately known, this does not provide insight into the overall commercial position of a shipper, given that this is determined by its overall contractual position in the market.

In respect of whether the information should be released when only relating to one terminal, respondents to the May open letter considered that Ofgem had changed its view from that published in the IA.

In the open letter we stated that we did not currently consider that the *intent* of the proposal was to delay implementation until further LNG importation facilities have begun operation. In the IA (paragraph 3.34) we discussed a hypothetical situation following the commissioning of other LNG facilities, whereby the operators of such facilities were not willing to provide the relevant data to NGG and therefore NGG would not be in a position to calculate aggregate stock levels. In such a situation, we considered that we would expect NGG to indicate that the levels were unknown, rather than it to publish the partial, and potentially misleading, data from those facilities that have made the stock information available. We therefore considered that in the future, i.e. when more than one LNG terminal was operational, the stock data relating to only a single facility should not be made publicly available. However, whilst we noted this potential situation in the IA, we would expect NGG to make every effort to obtain this information, and where appropriate to consider the terms of its connection agreements to facilitate its access to this information.

We accept that the IA was not altogether clear in this respect but, for the avoidance of doubt, this point was made simply in order to clarify that misleading information would not be published. We were not suggesting that we would have commercial confidentiality concerns where information is released only in relation to a single facility.

Withdrawal of information

In the IA, we recognised that there is some potential risk associated with the operators of the Grain facility withdrawing the provision of stock storage information to NGG and that the operators of new facilities coming on line may not be willing to provide the information to NGG. We still consider this to be highly unlikely, however, should NGG not have access to all of the information that it requires, we would expect NGG to indicate that the levels were unknown rather than publish partial, and potentially misleading, information. However, as noted above we expect NGG to make every effort to obtain this information.

Wider Statutory Duties

Security of supply

Responses to the consultations have suggested that security of supply could be diminished as a result of the release of aggregate LNG stock information. It has been suggested that increased regulation may discourage parties from:

- (a) importing LNG into GB;
- (b) investing in further GB LNG importation facilities ;
- (c) entering into contracts with National Grid which require them to disclose this information.

As we discussed in the IA, we remain of the view that the flow of LNG in the short term will largely be determined by existing contractual obligations, combined with the observed price differentials between different markets. In this respect, we think that parties are most likely to ship LNG to the market from which they would achieve the greatest return. In the longer term we continue to believe that investment will be driven by signals regarding evolving market fundamentals. Parties are most likely to construct LNG importation facilities where market fundamentals suggest that investment in additional sources of supply is required and therefore where they will receive a favourable return. Similarly we consider the contracts parties enter into with National Grid for operating margins gas will be considered on their economic merit, a fraction of which will be determined by clauses requiring the release on LNG stock information.

We therefore do not consider that the release of this information will have any material bearing either on participants' short term operational or long term investment decisions.

Impact on customers

We continue to believe that, as discussed in the IA, the majority of the benefits associated with the implementation of this proposal will be reaped by customers as a result of more efficient prices. We expect that large customers will use information regarding stocks at LNG importation facilities to directly inform their understanding of the GB supply picture and inform any commercial decisions that they make.

Costs of the modification

IT system costs

NGG has estimated that implementation of Modification 104 would cost around £55,000. This estimate incorporates costs associated with the changes that would need to be made to NGG systems in order to permit publication of aggregate LNG stock information on its website. In the IA we noted that these costs appear relatively high, but would be more than offset by the benefits that would be achieved associated with improved economic signals.

One respondent suggested that the costs of implementation of the proposed modification would be higher than the costs assessed for NGG by a factor of ten or more as those providing and handling the additional data would also face additional costs. We believe that as part of the safe operation of an LNG importation facility the information would be readily available to facility operators and as such any costs associated with releasing this information would be minimal.

We recognise that those market participants who choose to invest in systems to monitor this information may incur additional costs, although if they are currently attempting to model this information using other currently available data, their costs could, in fact, reduce. However, the decision to invest in systems to monitor this information is a

commercial decision that is taken voluntarily by the company and therefore should reflect the value that they place on capturing the information.

Implementation date

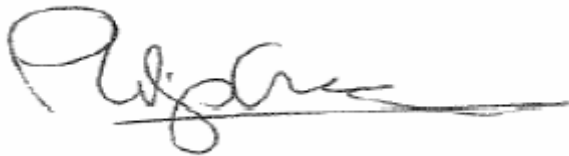
Given that we consider that the intent of the proposed modification does not necessarily require more than one operational LNG importation facility, and that any confidentiality concerns are limited, we consider that it is appropriate for this proposal to be implemented as soon as possible. In this respect, we note that NGG requires approximately 12 weeks following our decision to put in place the necessary systems for implementation.

Minded to decision

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority is minded to direct that modification proposal UNC 104: 3rd Party Proposal: Storage Information at LNG Importation Facilities be made.

In the case that the contents of this letter have altered your evaluation of the impact of the proposal we would be pleased to receive your amended views by 20 July 2007. Please send your responses to gb.markets@ofgem.gov.uk, for the attention of Andrew Wallace. Should you wish to discuss the contents of this letter Andrew Wallace (020 7901 7067) or Jamie Black (020 7901 7456) would be pleased to help.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Philip Davies', with a long horizontal line extending to the right.

Philip Davies
Director, GB Markets