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Steve Smith
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By E-mail: steve.smith@ofgem.gov.uk

Dear Steve,

OFGEM open letter dated 22 November 2007 re: anti-hoarding arrangements at the Isle of Grain importation facility ("Grain")

Thank you for the opportunity to comment on the above open letter. This non confidential response is made on behalf of Centrica plc excluding Centrica Storage Ltd. We are happy that Ofgem place this response on it's website and in the Ofgem library.

We welcome Ofgem's recognition in the letter that the underutilisation noted at Grain may be explained by a number of circumstances, including current demand and supply conditions in global LNG markets. We support the requirement for effective and practical anti-hoarding measures to be in place at exempted infrastructure. We also agree it is appropriate for Ofgem to monitor the effectiveness of arrangements attached to exemptions which have been granted. In addition, we continue to support the general principles of openness, transparency and non discrimination put forward by Ofgem.

As a capacity holder in Grain 2 and 3, we have a significant interest in the principle and practice of the anti-hoarding arrangements in place at Grain.

In general, Centrica does not believe that there are major issues with respect to the hoarding of importation capacity at Grain. We believe strongly that where the correct economic signals are present, then infrastructure such as Grain will be used. In our view, the lack of full usage of Grain in recent months can be explained by LNG market fundamentals, such as limited supply and strong demand in other markets (such as the US and Asia), which are willing to pay higher prices. We believe that this indicates a healthy and efficient market rather than any particular difficulties with anti-hoarding at specific terminals.

Whilst looking in the Atlantic basin it is correct to observe that prices would indicate UK delivery, but LNG is a global market and prices outside the Atlantic basin are also relevant.

Market intelligence and media reports suggests that Asian companies are paying the equivalent of 65-70 pence per therm, whilst UK spot prices have been closer to 45-55 pence per therm over a similar period. We see a reduction in LNG deliveries to the UK, EU and US as high prices attract cargoes to Asia. It is rational market behaviour for LNG to be going to Asia rather than Grain.

In terms of the general regime in place, recent evidence from Zeebrugge seems to indicate that the notice period has only a limited effect on secondary usage. It is also clear that globally there is at least twice as much regas capacity as liquefaction capacity and thus at any point in time it is reasonable to expect some surplus of regas capacity. At the recent Rome conference, comments from industry experts indicated that far from 100%, utilisation rates of nearer 33-50% may prove more typical for regas facilities. It is clear that in such cases, price competition for cargoes is likely to have much more impact on destination than the details of the secondary regime.

Our view that the key underlying issue at present is price rather than the regime applies to be the secondary capacity regime offered by BP/Sonatrach and the Grain LNG backstop anti-hoarding arrangements.

Moving to specifics, we are not able to comment in detail on the arrangements as we have not so far attempted to pre-qualify as a secondary shipper at Grain. We have sufficient faith in the operation of the market and normal commercial arrangements that at present we doubt the additional value that these secondary capacity arrangements would offer us. Market intelligence leads us to believe that bilateral contracting has successfully been employed on a number of occasions. This approach of using common commercial arrangements is the norm in the US and an examination of trades in to the US shows that commercial parties have established effective routes to market. We believe that this approach is entirely consistent with the market principles we support, and demonstrates that the nascent LNG market in the UK is making a good start.

In respect of the expense involved, a review of the information available on the websites makes clear that any aspirant user will be required to expend a considerable amount of money to pre-qualify as a secondary shipper. It also seems likely that many such expenses are not, in fact, one off payments. We would propose that existing capacity holders should facilitate a prospective user's ability to review documents and therefore we would not support a charge being levied to allow document review.

Our review of the publicly available documentation however has thrown up one very specific concern in relation to NTS Entry Capacity.

The public guidance on access to secondary capacity[1] stipulates as part of the Secondary Shipper Activities that the Secondary Shipper will ensure that it has sufficient NTS Entry Capacity to accommodate send out of its physical volumes. From the document, broadly, the Secondary Service available would include use of a berthing slot, unloading capability and temporary storage for 6 or 7 days. In the light of this, we believe that in order to evacuate a full cargo over a 6-7 day period, any Secondary Shipper would need to be flowing firm into the full capacity permitted in order to complete the evacuation. Hence, in completing the process, the Secondary Shipper presumably needs to acquire firm NTS Entry Capacity at Grain.

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[1] Access to Secondary Capacity in Phase 1 of the Isle of Grain LNG Import and Regasification Terminal – A guide for prospective Secondary Shippers, version 1.0 – 31st August 2007.

There have been considerable developments in the area of Entry Capacity in recent months, in particular the Trades and Transfer initiative. As a result of the latest allocation, we understand that the Baseline position at Grain has changed significantly for this winter.

Originally, the Grain Baseline was c. 175GWh available and as little of this had been purchased in the QSEC or RMSEC auctions, c. 173 GWh was transferred to provide c. 80GWh of additional capacity at Easington which has been sold as firm. This reduces the available day ahead firm capacity at Grain to less than 2GWh, leaving any prospective Secondary Shipper to rely on such Interruptible Entry Capacity as National Grid may make available. We believe that this may make it very difficult for any Secondary Shipper to commit to the use of the Secondary arrangements this winter.

As a final observation, and acknowledging the points recognised by Ofgem in the letter about Grain presently being the only terminal, it is essential to recognise that the LNG trade is heavily driven by longer term planning and logistics. In addition, given the long term nature of the business, it is important that the benefit of stability in the regime is recognised and valued, unless there is good reason for change. We have seen no evidence that the current rules are contributing to low utilisation of capacity at Grain and hence we are not convinced that change is necessary.

The volume available for short-term trading is small and the UK's supply sources are more likely to come from a set of suppliers such as Qatar, Algeria and Egypt that are entirely dependent upon their ability to forward plan deliveries and vessel movements on a long term, firm basis. We must recognise that any measures that are taken that are disruptive to this programming ability could be detrimental to the overall arrival of LNG into the UK. Care must be taken that decisions are not taken in what are atypical market conditions ahead of the commencement of long-term trades and the opening of additional terminals.

As a major purchaser of gas in the UK that is dependent upon the efficient working of the UK market we would like to reiterate that we are fully supportive of your objectives, and in particular, practical, effective, anti-hoarding measures but we urge recognition of the unique characteristics of the global LNG business both in terms of arbitrage and logistics.

We hope these comments have been helpful, and we would be happy to discuss them further. If you would like to pick up any points in more detail, Alison Russell (07789 570046, Alison.russell@centrica.com) would be happy to co-ordinate.

Yours sincerely,

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