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# Consultation on the regulated Third Party Access regime for Liquefied Natural Gas facilities in Great Britain

## Consultation

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### Overview:

From 3 March 2011 LNG facilities have an obligation to comply with the EU Third Internal Energy Package (the Third Package), and in particular the directly applicable provisions of the Gas Regulation and the relevant provisions of the Gas Directive as transposed into domestic legislation.

Ofgem is responsible for ensuring general compliance with the requirements of the Third Package pertaining to Liquefied Natural Gas (LNG) facilities. Given this, we have developed this consultation document to help address queries from perspective investors and industry stakeholders. The objective is to provide greater certainty and clarity on how we may be minded to interpret the provisions of the Third Package.

This document sets out Ofgem's preliminary views regarding compliance with regulated third party access (rTPA) arrangements for LNG facilities in Great Britain (GB). We expect to issue a guidance document following consultation, which will apply until revised.

## Context

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Liquefied Natural Gas (LNG) facilities play an important role in facilitating the efficient functioning of the energy market in Great Britain (GB). LNG imports are becoming an increasingly important source of supply to the GB gas market and therefore contribute to security of supply and competition in the market.

On 3 September 2009, the European Union's Third Internal Energy Package (the Third Package) came into force and included Directives and Regulations on gas and electricity. While the Regulations have been applicable since 3 March 2011, the Directives have yet to be transposed into British law. However, draft regulations (The Electricity and Gas (Internal Markets) Regulations 2011) have been submitted to the British Parliament for approval – importantly, a number of aspects of this legislation will be applicable to LNG facilities.

## Associated documents

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- [DIRECTIVE 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC.](#)
- [Regulation \(EC\) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation \(EC\) No 1775/2005.](#)
- [DIRECTIVE 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC.](#)
- [REGULATION \(EC\) No 1775/2005 of the European Parliament and of the Council of 28 September 2005 on conditions for access to the natural gas transmission networks.](#)
- [Enforcement Guidelines on Complaints and Investigations, Ofgem, 28 September 2007.](#)
- [The Electricity and Gas \(Internal Markets\) Regulations 2011.](#)
- [ERGEG Guidelines for good third party access for LNG system operator, May 2008,](#)
- [ERGEG Guidelines for Good Practice on Open Season Procedures \(GGPOS\), May 2007.](#)

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## Executive Summary

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This consultation document sets out our preliminary views on how we are minded to interpret provisions relating to third party access to Liquefied Natural Gas (LNG) facilities in Great Britain (GB) – the default arrangement for LNG facilities in GB.

As all existing LNG facilities in GB have been granted an exemption from third party access, this document is primarily aimed at providing potential investors greater clarity on how rTPA arrangements will operate in GB. We consider that this document will provide clarity with respect to how rTPA arrangements may operate relative to an exemption, thereby facilitating an effective comparison of the options available to a potential LNG investor. Importantly, this document does not alter the status of any exemptions that have been granted nor does it seek to remove the scope for potential investors to seek an exemption from rTPA arrangements.

This document also explores the proposed legislative amendments that will affect all LNG facilities in GB. For example, we outline the new monitoring and enforcement powers that will apply to all LNG facilities in GB. Put simply these powers will mean that LNG facilities will be subject to the same monitoring and enforcement rules that have previously only applied to licensed persons.

We are consulting now on this document for a number of reasons. Industry has been requesting consultation of this type to assist it in making investment decisions, a number of which are expected to be made shortly, and which is of interest given the growing importance of LNG to GB's energy needs.

Importantly, in developing our consultation document we have been conscious of the need to ensure that rTPA arrangements are effective in the context of the GB market – a market where investment decisions are driven by market signals and where all LNG facilities are currently exempt from rTPA arrangements. Some aspects of this document are also relevant for exempted facilities. More generally, the rules for rTPA may affect the economics of exempted facilities.

We expect a number of benefits to arise from developing this document, including:

- for potential investors, it will provide greater clarity around the regulatory framework and should therefore improve the investment climate;
- for LNG facility customers, by supporting more transparent and non-discriminatory access arrangements, it will facilitate efficient use of LNG facilities operating under rTPA arrangements; and
- for end consumers, it will facilitate increased security of supply and increased competition (as more LNG facilities are brought to the market).

We are also providing this document to reduce the risk of non-compliance with the new legal framework. The document outlines the enforcement tools that we will have in the event that non-compliance with rTPA arrangements is suspected.

## Key features of this consultation document

The key features of our consultation document on regulated third party access for LNG facilities in GB are:

**Capacity allocation mechanisms and congestion management procedures:** our preliminary view is that auctions are the most appropriate market based mechanism to determine tariffs under rTPA arrangements. We also outline that the mechanisms that can be used to allocate unused capacity (anti-hoarding arrangements) need to be transparent and non-discriminatory.

**Transparency and information provision:** our preliminary view is that all LNG system operators will be required to publish all relevant information on their websites and to provide it directly to existing and potential customers upon request. Importantly, we have sought to identify differences that apply to exempt and rTPA facilities. We consider that equitable and timely access to information facilitates informed decision making by market participants. We also consider that improved transparency will help reduce barriers to entry and will facilitate competitive markets.

**Governance, monitoring and enforcement:** our position is that we will adopt a mix of monitoring and industry engagement to determine whether or not LNG system operators are complying with the relevant regulatory requirements. The proposed monitoring and enforcement provisions will enable us to engage in a mix of proactive market surveillance, and to investigate and take appropriate action against all LNG market players where there is reason to believe compliance with the relevant regulatory requirements are not being met.

## Next steps

We are seeking stakeholders' views on this document and have therefore posed a number of questions within it. Respondents are encouraged to reply to those questions and to provide views on any other matter they consider relevant to our proposed approach to rTPA arrangements for LNG facilities in GB.

The consultation period for this document will run for eight weeks, from 30 September to 25 November 2011. During this period we may, subject to stakeholders' feedback, meet with stakeholders to discuss the views set out in this document. Following the completion of the consultation process we will publish our guidance document on rTPA arrangements for LNG facilities in GB.

That guidance document will state our final views on rTPA arrangements for LNG facilities in GB, however, we reserve the right to amend that guidance in light of future developments. We may also be minded to take a different approach to that indicated in the guidance where the facts of the matter in question are novel or complex. Where we decide to revise the guidance, we always will endeavour to consult stakeholders, unless there is a need for urgency.

# 1. Introduction

## Chapter Summary

This chapter provides background on the LNG market, highlights its importance to the GB energy market and briefly outlines the legislation relevant for LNG facilities in GB. It also provides information on this document's purpose and its structure.

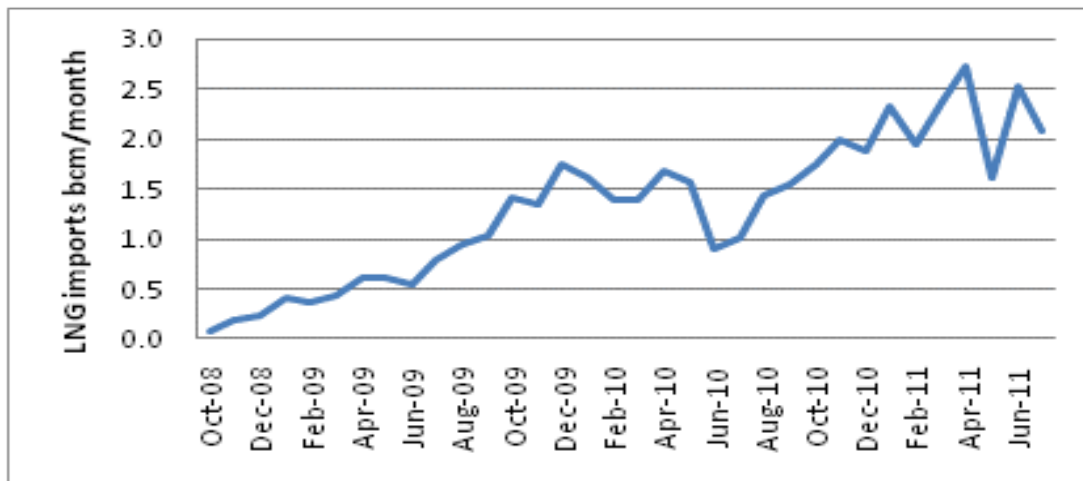
## Question box

There are no specific questions in this chapter.

## Role of LNG in the GB market

1.1. Liquefied Natural Gas (LNG) is an increasingly important source of energy for Great Britain (GB). LNG imports have increased from almost zero in October 2008 to over two billion cubic meters (bcm) per month in June 2011 (see Figure 1). Going forward, our reliance on LNG imports is expected to grow and we see benefits for consumers in creating a regulatory environment that provides clarity and certainty, which in turn facilitates efficient investment decisions. By 2021, LNG is expected to provide 40% of UK's gas needs (National Grid, Gas Transportation Ten Year Statement 2010)<sup>1</sup>.

**Figure 1: UK LNG imports October 2008 to July 2011**



Source: National Grid.

<sup>1</sup> Last winter (2010/11) LNG already provided on average 17% of total gas demand in the UK (Source: National Grid).

1.2. There are currently three<sup>2</sup> LNG facilities in GB, which provide a total re-gasification capacity of 47 bcm/year. This re-gasification capacity has been built within the last six years<sup>3</sup>. Table 1 below shows the re-gasification capacity and ownership at these three LNG facilities.

**Table 1: Re-gasification capacity and ownership at the three GB LNG facilities**

LNG facility	Ownership	Total re-gasification capacity (bcm/y)
Isle of Grain	Grain LNG Ltd	20.3
Dragon	Dragon LNG Limited	6
South Hook	South Hook LNG Terminal Company Ltd	21
Total		47.3

Source: LNG system operators' applications for an exemption from Section 19D Gas Act 1986.

## How LNG facilities in GB have been operating

1.3. The three LNG facilities operating in GB have been issued with exemptions from third party access requirements, the default regime in GB. This means that each LNG facility has demonstrated to Ofgem and the European Commission that it meets all the criteria for the granting of an exemption that are listed in section 19C of the Gas Act<sup>4</sup>.

1.4. We consider that through the granting of these exemptions we have provided industry with sufficient information as to the regulatory requirements under the exempted regime. However, we are also conscious of the need to ensure that the rTPA arrangements are effective in the context of the GB market – a market where, to date, all facilities have been granted exemptions from rTPA arrangements.

<sup>2</sup> Isle of Grain, Dragon and South Hook. There is also Gasport, a re-gasification vessel, which is not strictly considered as an 'LNG import/export facility'. Gasport's capacity is not included in any of the figures/charts included in this document.

<sup>3</sup> Isle of Grain was built in three phases: phase 1 was completed in July 2005; phase 2 in December 2008; and phase 3 in December 2010. South Hook facility was developed in two phases – the first phase was completed in April 2009 and the second phase in April 2010. Dragon was completed in September 2009.

<sup>4</sup> The criteria that must be met in order to be granted an exemption, as set out in section 19C of the Gas Act, are: a) the facility will promote security of supply; b) the level of risk is such that investment would have not been made without the exemption; c) the facility is to be owned by a person other than the gas transporter who operates the pipeline system connected to the facility; d) charges will be levied on users of the facility; e) the exemption will not be detrimental to competition, the operation of an economically efficient gas market or the efficient functioning of the pipeline system connected to the facility; f) the European Commission is content with the exemption.



## The purpose of this document

1.5. This document sets out our preliminary views on how we are minded to interpret provisions relating to third party access to LNG facilities in GB – the default arrangement for LNG facilities. We have issued this consultation as we recognise the growing importance of LNG to GB’s energy needs and the need to create a clear and balanced regulatory environment that facilitates efficient LNG investment decisions in GB. This is particularly relevant given the expected level of additional LNG facility investment in coming years<sup>5</sup> and industry’s representations that such consultation would be useful.

1.6. As noted above, all LNG facilities in GB have been granted exemptions to the third party access regime, this document is therefore primarily aimed at investors that have yet to invest in GB but who may be considering operating under the rTPA regime. It seeks to address the lack of information that may be hindering an effective comparison of the options available to potential LNG investors to develop an LNG facility in GB. Put simply, we want to facilitate efficient investment decisions and ensure there is effective competition between facilities that may operate under different approaches.

1.7. For the avoidance of doubt, this document does not alter the status of any exemptions that have been granted nor does it seek to remove the scope for potential investors to seek an exemption from the rTPA arrangements.

1.8. The benefits that we expect to see as a result of the release of this document include:

- for potential investors, it will provide greater clarity around the regulatory framework and increase certainty associated with investment;
- for LNG facility customers, by supporting more transparent and non-discriminatory access arrangements, it will facilitate efficient use of LNG facilities operating under the rTPA arrangements; and
- for end consumers, it will facilitate increased security of supply and increased competition (as more LNG facilities are brought to the market).

1.9. This document also consults on guidance in relation to compliance with relevant legislation for rTPA to LNG facilities. It outlines the measures that an LNG system operator under an rTPA regime can adopt to help reduce the risk of non-compliance with the relevant legislation. It also outlines the expected enforcement tools that will be available to us should non-compliance with the rTPA arrangements be suspected.

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<sup>5</sup> According to data supplied by National Grid in its 2010 Ten Year Statement, at least five other LNG facilities are at various stages of planning. Ofgem’s ‘Corporate Strategy and Plan 2011–16’ also states that we will continue to review our regulatory treatment of TPA at LNG facilities to promote future investment.

1.10. While this document highlights our preliminary views on some of the issues to which the Authority<sup>6</sup> is likely to have particular regard when considering compliance with the legislation relating to access to LNG facilities, it is by no means definitive or exhaustive. The objective of this consultation is to develop general guidance for LNG system operators and other market participants.

1.11. Following the completion of the consultation process, we will publish our guidance on rTPA arrangements for LNG facilities in GB. That guidance will state our final views on rTPA arrangements for LNG. Importantly, we reserve the right to amend that guidance in light of future developments and to take different approaches in individual cases not foreseen in preparing it. We would normally consult publicly before making major changes to it, unless there is a need for urgency.

## Relevant legislation

1.12. For EU Member States, the regulatory framework used to underpin Third Party Access (TPA) arrangements for LNG facilities was set down in the First Gas Directive<sup>7</sup>. This regulatory framework has been refined and strengthened in the two subsequent EU legislative packages for internal energy markets.

1.13. In September 2009, the EU Third Internal Energy Package was published. For the purposes of this document the relevant components of the Third Package are the Gas Directive and the Gas Regulation<sup>8,9</sup>. Since 3 March 2011, the Gas Regulation has been directly applicable, while the Gas Directive has recently been laid before the British Parliament (The Electricity and Gas (Internal Markets) Regulations 2011) and is expected to be passed by Parliament shortly.

1.14. The main provisions of the Third Gas Directive relating to rTPA arrangements for LNG facilities require Member States to ensure (Article 32):

- the implementation of a system of third party access to LNG facilities based on published tariffs, applicable to all eligible customers, including supply undertakings, and applied objectively and without discrimination between system users; and
- that those tariffs, or the methodologies underlying their calculations are approved prior to their entry into force by a regulatory Authority – and the methodologies, where only methodologies are approved – are published prior to their entry into force.

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<sup>6</sup> For the purposes of this document the terms Authority, the Gas and Electricity Markets Authority, Ofgem and 'we' should be considered interchangeable.

<sup>7</sup> Directive 98/30/EC of the European Parliament and of the Council of 22 June 1998 concerning common rules for the internal market in natural gas.

<sup>8</sup> Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC ("Gas Directive").

<sup>9</sup> Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005 ("Gas Regulation").

1.15. LNG system operators also have an obligation to comply with the directly applicable provisions of the Gas Regulation and the relevant provisions of the Gas Directive, which (as mentioned above) are expected to be transposed into domestic legislation shortly.

1.16. Put simply, the provisions of the Third Package relating to rTPA are intended to ensure that LNG facilities provide access in an objective, transparent and non-discriminatory basis.

1.17. As noted earlier, this document is primarily aimed at clarifying the rTPA arrangements for potential investors in the GB market. As such, throughout this document we focus on describing the legal provisions applicable to LNG facilities operating under the rTPA arrangements. However, where necessary we outline the provisions applicable to exempted facilities.

## **Structure of this consultation document**

1.18. This document is split into four chapters:

- chapter 2 sets out our preliminary views on capacity allocation mechanisms and congestion management procedures;
- chapter 3 outlines our preliminary views on transparency and information sharing; and
- chapter 4 provides our preliminary views on governance, monitoring and enforcement.

## 2. Capacity allocation mechanisms and congestion management procedures

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### Chapter Summary

This chapter outlines our preliminary views on how LNG system operators<sup>10</sup> under an rTPA regime in GB should allocate capacity and the congestion management procedures they should adopt. It also provides views on how they should consult the market to reduce the risk that their main commercial conditions, and the services that they provide, discriminate against actual or potential system users.

### Question box

**Question 1:** What level of consultation should an LNG system operator undertake when developing its main commercial conditions for the first time or when proposing amendments to its standard terms and conditions?

**Question 2:** Should an LNG system operator be expected to formally consult or test the market before changing existing services or offering any new services to the market? If no, please provide your reasons.

**Question 3:** Do market participants have any concerns with our preliminary views on capacity allocation?

**Question 4:** Can the Use It or Lose It (UIOLI) arrangements implemented by the LNG system operators in GB be improved to ensure greater utilisation? What lessons can we learn from current models to encourage greater use under an rTPA regime?

**Question 5:** Do market participants have any views on why secondary capacity trading has been used so little? Is access to unused capacity being facilitated through mechanisms other than secondary trading and/or UOLI arrangements?

**Question 6:** Are there any mechanisms that could be established to facilitate greater use of secondary trading arrangements?

2.1. In this chapter, we briefly outline the relevant legislation and then outline the maximum capacity requirements. We then provide our preliminary views on how LNG system operators under rTPA arrangements should consult the market regarding the commercial services that they intend to provide. Finally, we outline our preliminary

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<sup>10</sup> The term LNG system operator refers to natural or legal person who carries out the functions of liquefaction of natural gas, or the importation, off-loading and re-gasification of LNG and is responsible for operating an LNG facility (see article 2(12) of the Gas Directive). The Directive does not distinguish between the owner and the operator of an LNG facility, for the purposes of this document where we use the term 'operator' this includes the owner or the legal entity that is responsible for managing an LNG facility. Other terms captured by our simplification are 'LNG operator', 'facility operator' and 'operator'.

views on capacity allocation mechanisms and congestion management procedures, including anti-hoarding arrangements.

## Relevant legislation

2.2. Most of the legal provisions included in the Third Package are only applicable to LNG facilities operating under rTPA arrangements. In particular, under the Gas Regulation and the Gas Directive, LNG system operators under an rTPA regime are required to:

- offer the maximum capacity available at their facilities to market participants (Article 17(1) of the Gas Regulation);
- consult the market on the services that they may provide if required by the Authority (19D of the Gas Act)<sup>11</sup>;
- provide market participants with a mix of services under non-discriminatory terms and conditions (Article 15 of the Gas Regulation); and
- implement rTPA arrangements which are objective, transparent and non-discriminatory and operate in accordance with the specific requirements of Article 32 of the Gas Directive and Articles 13, 17 and 22 of the Gas Regulation.

2.3. These requirements are discussed in more detail throughout this chapter.

## Defining the maximum capacity

2.4. Article 17(1) of the Gas Regulation (applicable to LNG facilities operating under rTPA arrangements) requires 'that the maximum LNG facility capacity shall be made available to market participants, taking into account system integrity and operation'. The maximum LNG capacity shall reflect the maximum technical capacity of the infrastructure such as number of jetties, berths, working storage tank capacity for temporary LNG storage and regasification capacity.

2.5. We recognise that defining the maximum technical capacity at an LNG facility can be complex. For example, the specific technical attributes and characteristics of a facility (e.g. number of berthing slots, vaporisers and the timing of redelivery) can have implications for the extent to which LNG capacity may vary. Our preliminary view is therefore that we would expect that any quantification of maximum technical LNG capacity (and associated variations to it) to be justifiable and fully consistent with the LNG facility's own technical parameters, operational processes, procedures and guidelines.

2.6. We also consider that LNG system operators under rTPA arrangements, in line with the requirements of Article 19(1) of the Gas Regulation, should make public detailed technical information (e.g. size of LNG tankers accepted, size of LNG temporary storage tanks etc.) associated with their facilities. We consider this type of

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<sup>11</sup> This requirement is actually included in the Gas Act and not in the Third Package.

information is necessary to allow users to gain effective access to LNG facilities<sup>12</sup>. We consider that this information should be available on a facility's website.

2.7. In practical terms, the objective of these provisions is to ensure that LNG capacity is not withheld from market participants, so that all available capacity is offered to the market.

2.8. In addition, in line with the requirements of both Articles 19(2) and 19(4) of the Gas Regulation, LNG system operators are required under rTPA arrangements to:

- inform market participants on contracted and available capacities at their facilities on a numerical, rolling and regular basis; and
- make public the amount of gas, inflows and outflow at each LNG facility and the available LNG facility capacities<sup>13</sup>.

## Consulting the market

2.9. Under the Gas Act (section 19D(2B)) LNG system operators may be required by the Authority to consult the market before developing the main commercial terms and conditions applying to their facilities under the rTPA arrangements<sup>14</sup>.

2.10. A number of other provisions contained within Articles 15 of the Gas Regulation also deal with requirements for an LNG system operator to not discriminate in the provision of services. In particular Article 15(4) states that "third party access services may be granted subject to appropriate guarantees from network users with respect to the creditworthiness of such users. Such guarantees shall not constitute undue market barriers and shall be non-discriminatory, transparent and proportionate". In addition, Article 15 (5) requires that 'any contractual limit on the required minimum size of LNG capacity shall be justified on the basis of technical constraints'.

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<sup>12</sup> Both Articles 19(2) and 19(4) require an LNG system operator to make public information about the available technical capacity. The available capacity should be the residual between the maximum capacity and the capacity that has been contracted (19(2)) or that is being utilised (19(4)). Given this, market participants will require information about the maximum technical capacity.

<sup>13</sup> In the case of a dispute between an LNG system operator and a market participant, we expect an LNG system operator to be able to clearly demonstrate that it has been making the maximum LNG facility capacity available to market participants. We note that under Article 20 of the Gas Regulation, an LNG system operator is required to keep the relevant information for five years (information requirements are described in more detail in chapter 3).

<sup>14</sup> Specifically, section 19D(2B) of the Gas Act indicates that before the owner of an LNG facility (operating under an rTPA regime) seeks approval under subsection (2A) they must carry out such consultation as the Authority may require.

## **Our view on consulting the market**

2.11. We consider that consulting the market on capacity and the main commercial services offered mitigates the risk that LNG system operators could use contractual arrangements to discriminate between facility users (or potential facility users).

2.12. We also consider that an LNG system operator should consult system users where it may be:

- offering new or additional capacity or services in the GB market;
- considering significant changes in the mix of services that it intends to offer in the GB market; or
- where there is a significant change in market conditions<sup>15</sup>.

2.13. To demonstrate compliance with the requirements of the Third Package and the Gas Act we also expect that an LNG system operator under rTPA arrangements will be able to clearly demonstrate that:

- appropriate measures were taken to ensure an appropriate form and level of consultation; and
- the views of its respondents were given appropriate consideration in determining the main commercial conditions.

## **Services offered**

2.14. With respect to the services offered, our preliminary view is that an LNG system operator is best placed to determine the appropriate mix of services that it wishes to test and potentially provide to the market, ensuring they have non-discriminatory terms and conditions and are compatible with use of interconnected gas transport systems. We consider that this position will provide an LNG system operator with the opportunity to explore with the market the best suite of services that will maximise the efficient use of the LNG facility.

2.15. The Guidelines for Good Third Party Access Practice for LNG System Operators (GGPLNG)<sup>16</sup> also provide some guidance as to what should be provided by an LNG system operator with respect to services.

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<sup>15</sup> An LNG system operator can test the market demand for different services as part of an open season process. LNG system operators may refer to the Guidelines for Good Practice on Open Season Procedures (GGPOS) – see associated documents section at the front of the document.

<sup>16</sup> See associated documents section at the front of the document.

## Provisions on allocation mechanisms

2.16. Article 32 of the Gas Directive requires national regulatory authorities to approve tariffs or the methodologies underlying the calculation of published tariffs prior to their entry into force.

2.17. Article 13(1) of the Gas Regulation states that Member States 'might decide that tariffs may also be determined through market based arrangements, such as auctions, provided that such arrangements and the revenues arising from them are approved by the regulatory authority'<sup>17</sup>.

2.18. Article 17(2) of the Gas Regulation also lays down the principles applying to LNG capacity allocation. Under this article, LNG system operators under rTPA arrangements are required to implement and publish non-discriminatory and transparent capacity allocation mechanisms which shall:

- provide appropriate economic signals for the efficient and maximum use of capacity and facilitate investment in new infrastructure (17(2)(a));
- be compatible with the market mechanisms including spot markets and trading hubs, while being flexible and capable of adapting to evolving market circumstances (17(2)(b)); and
- be compatible with the connected network access systems (17(2)(c)).

2.19. Our interpretation of the provisions of Article 17 of the Gas Regulation is that they are intended to ensure that LNG capacity is allocated to the market participants that place the highest value on this capacity irrespective of who the customer is.

2.20. In addition, Article 15(1)(a) of the Gas Regulation requires an LNG system operator under an rTPA regime to offer services on a non-discriminatory basis to all network users that accommodate market demand; and offer the same services to different customers under equivalent terms and conditions.

2.21. ERGEG guidelines (GGPLNG) also recommend that allocation mechanisms should not hamper the entry of new market participants or create undue barriers to market entry.

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<sup>17</sup> The Gas Act (section 19D (2A)) also requires that 'the cost or the method of determining the cost of acquiring the right to have liquid gas treated in a relevant facility and any change thereto must be approved by the Authority prior to their publication'.



## Choice of allocation mechanism

2.22. As outlined in the previous section, the Third Package does not stipulate a specific allocation process for LNG capacity for LNG facilities that are using the rTPA regime. LNG capacity can be allocated through market based arrangements, such as auctions, provided that the revenues thereof are approved by the appropriate regulatory authority.

2.23. As the National Regulatory Authority responsible for ensuring compliance with the Third Internal Energy Package we consider auctions are the most appropriate market based arrangement by which primary capacity can be allocated. We consider that auctions are an effective mechanism by which the various regulatory requirements can be met. Specifically, we consider that an auction:

- is more likely to result in an efficient allocation of LNG capacity in GB as capacity will go to the customer who places the highest value on it – as reflected in the final auction price<sup>18</sup>;
- will make it easier for an LNG system operator to demonstrate that its allocation process is free from discrimination<sup>19</sup>; and
- will provide better signals for potential new investment, as it can provide relatively more information about the level of demand for regasification capacity and the value that market participants place on it.

2.24. Where an auction is used to allocate capacity, Ofgem is required to approve the auction arrangements and the revenues arising from them<sup>20</sup>. Importantly, our view on this requirement is that approval of the methodologies and mechanisms which underpin the auction process can imply approval of the revenues arising from it.

2.25. Our preliminary view on the steps that an LNG system operator needs to complete to gain our approval of its proposed auction arrangements are that it will need to:

- Provide us with a description of its proposed auction arrangements, including its reserve price methodology (where appropriate) for allocating primary capacity and its anti-hoarding arrangements (this includes its secondary trading arrangements and its Use It or Lose It (UIOLI) arrangements). A more detailed

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<sup>18</sup> In a market where there is only a single customer or a small number of (large) customers it is possible for customers to have market power. In these situations, it is possible for customers to use their market power to make the LNG facility sell capacity at a price that is insufficient for them to generate a return on its investment.

<sup>19</sup> This is because the methodology for allocating LNG facility capacity under an auction can be clearly specified, thereby reducing the potential for the LNG system operator to use its discretion when accepting or rejecting bids. Similarly, it should be relatively straightforward to audit auction results to determine whether capacity has been allocated appropriately.

<sup>20</sup> See Article 13(1) of the Gas Regulation.

list as to the issues we will need to consider in any assessment is detailed in Appendix 2<sup>21</sup>.

- Release the detail of its proposed auction arrangements (except with respect to the reserve price methodology if applicable<sup>22</sup>), for public consultation for a period of at least four weeks. To facilitate maximum stakeholder participation, Ofgem offers to inform stakeholders that such a consultation has commenced.
- Following the closing of the consultation period, submit to us:
  - copies of all submissions received;
  - a report summarising respondents' views and how it has considered these views in its final proposed auction arrangements; and
  - its final proposed auction arrangements for approval.

2.26. Following receipt of this information, we will then assess the proposed auction arrangements to ensure that it meets the non-discriminatory, objective and transparency criteria set by legislation, and that they do not create any undue barriers to market entry. As part of our assessment we may request additional information on any aspect of the auction arrangements, including secondary capacity, before giving our final approval.

2.27. Importantly, while we will be requesting information on anti-hoarding and secondary capacity arrangements, it will be the system operator's responsibility to ensure that its UIOLI arrangements and secondary capacity trading arrangements are effective. We are only requesting this information to ensure that market participants have sufficient information available to make informed decisions as to what amount of primary capacity they wish to purchase.

2.28. For the sake of clarity, a bilateral negotiation which is not part of an objective, transparent and non-discriminatory process will not meet the requirements of the Gas Regulation.

## Open season procedures

2.29. In the case of new investment, we consider that open season procedures can provide an acceptable alternative to auctions, to ensure a comprehensive market consultation and non-discriminatory allocations. An open season process should involve two phases:

- *Phase 1 – the preparatory phase*: during this phase a potential investor will assess how much capacity the market needs and under what terms (i.e. price and contract duration). As part of this phase the investor will need to effectively communicate with potential open season participants.

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<sup>21</sup> The GGPOS also provides information on what information should be provided to interested third parties.

<sup>22</sup> We do not consider that the release of this information is relevant to all market participants. This information will, however, be useful to Ofgem in determining if the requirements meet the various regulatory requirements.

- *Phase 2 – capacity allocation*: during this phase, an investor will offer capacity to the open season participants and, if satisfied with the offer, open season participants will sign a binding agreement with the investor.

2.30. In general, our view is that market based arrangements, whether auctions or open season procedures as described above, are the most appropriate method to determine tariffs in the GB market. Our preliminary view is therefore that we do not encourage any other tariff approval as part of our rTPA arrangements but we reserve the right to revisit this policy position to accommodate future developments.

2.31. Perspective investors can refer to ERGEG's Guidelines for Good Practice on Open Season Procedures (GGPOS) for further information and guidance.

## **Contractual congestion and anti-hoarding arrangements**

2.32. The Gas Regulation (Article 17 (3)) sets out the principles that under an rTPA regime should apply in a case of contractual congestion<sup>23</sup>. Under this article, LNG contracts are required to include measures to ensure any spare capacity is made available (anti-hoarding arrangements) to the market by LNG system operators and/or LNG facility users. The aim of these provisions is to ensure that an LNG facility is fully utilised by maximising the use of its technical capacity.

2.33. In the next two sections of this chapter we discuss the anti-hoarding requirements of Article 17(3) and other secondary provisions of the Gas Regulation for LNG system operators and LNG facility users operating under rTPA arrangements. We also describe the current anti-hoarding arrangements applied at exempted facilities in GB and outline our preliminary views on what these arrangements would look like under an rTPA regime.

### **Anti-hoarding arrangements – LNG system operator**

2.34. Article 17(3)(a) of the Gas Regulation requires the LNG system operator to 'offer unused LNG facility capacity on the primary market without delay'. Other provisions of the Gas Regulation also have implications for the arrangements an LNG system operator has to put in place to prevent capacity hoarding. For example:

- Article 17(2) of the Gas Regulation requires the arrangements to be transparent and non-discriminatory.
- Article 15(3)(a) and Article 15(3)(b) of the Gas Regulation require that LNG contracts that are signed outside a natural gas year with non standard dates or with a shorter duration than a standard LNG contract shall not result in arbitrarily higher tariffs.

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<sup>23</sup> Article 2(1)(21) of the Gas Regulation defines contractual congestion as a 'situation where the level of firm capacity demand exceeds the technical capacity'

2.35. The objectives of all of the above mentioned provisions are to:

- allow unused capacity to be made available to the market so as to maximise the use of an LNG facility<sup>24</sup>;
- ensure that those parties that value LNG capacity most can gain access to it; and
- limit the potential for LNG primary capacity holders to withhold capacity from the market.

2.36. As the legislation (Article 17(3)) requires that unused capacity be returned to the primary market, we would also expect LNG system operators to adhere to the principles outlined in the choice of allocation mechanism section above when allocating unused capacity at their facilities. That is, we would expect any mechanism used to allocate unused capacity to be transparent and non-discriminatory.

2.37. To make the arrangements of Article 17 (3)(a) work, it will also be important that LNG system operators meet the requirements of Articles 19(2) and 19(4) of the Regulation and provide market participants with sufficient information about the available capacity. This information should also be made available on a daily basis. The provision of this type of information would help potential LNG users to make informed decisions as to what amount of capacity they might want to purchase. This information will also provide market participants with a better basis for determining whether LNG system operators are making the maximum capacity available.

2.38. Currently, the three exempted LNG system operators in GB are required (under the terms of their exemption) to offer unused LNG capacity to the market via UIOLI arrangements or secondary capacity trading.

2.39. However, despite LNG system operators in GB providing UIOLI arrangements, we understand that these arrangements are rarely (if at all) used. We consider that this may result in LNG facilities being under-utilised thereby ensuring a situation where those who most value LNG capacity are not actually gaining access to it. While we recognise that the presence of contractual or structural arrangements may be at the root of this problem, we are keen to gain a better understanding as to why current UIOLI arrangements could be ineffective, as continuing with such arrangements and applying them under an rTPA framework may be to the ultimate detriment of consumers.

2.40. We are therefore interested in hearing industry's views on UIOLI arrangements and whether they could be improved to facilitate greater use of LNG facilities in GB, which would be to the ultimate benefit of consumers.

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<sup>24</sup> LNG system operators should manage the capacity portfolio 'with a view to optimal and maximum use of technical capacity and the timely detection of future congestion and saturation points' (Article 2 (5) Gas Regulation).

### **Anti-hoarding arrangements – LNG facility users**

2.41. The provisions of Article 17(3)(b) entitle LNG facility users<sup>25</sup> who wish to re-sell their contracted capacity on the secondary market to do so. Furthermore, LNG system operators are required to facilitate this secondary trading by taking 'reasonable steps to allow capacity to be freely tradable on and to facilitate such trade in a transparent and non-discriminatory manner'<sup>26</sup>.

2.42. Secondary trading is important as it permits unused capacity, held by the primary capacity holders, to be transferred to market participants that place a higher value on the capacity at different points in time. Secondary trading also provides market participants with the ability to adjust their position in the market and effectively respond to changes in their circumstances. For example, a market participant may not require the LNG capacity when it was initially being allocated, but changes in its market position may result in it subsequently placing a higher value on that capacity than other market participants that purchased the capacity in the primary allocation process. The use of secondary trading will therefore result in more efficient use of the facility which is to the ultimate benefit of consumers.

2.43. Similar to the previous section that discussed UIOLI arrangements, we understand that the extent to which secondary capacity trading is used at the three exempted facilities in GB is marginal. This may result in underutilisation of LNG facilities, which is not efficient and which may be to the ultimate detriment of consumers. The low level of secondary capacity trading currently experienced in GB may reflect that other arrangements are being used. We would welcome industry's view on this issue. We would also welcome views on whether there are any mechanisms that LNG system operators could put in place to encourage greater use of secondary capacity trading. On the assumption that further refinements are identified we would consider that exploring these may be beneficial for an rTPA model, as it would help improve overall efficiency of the LNG market and this would be to the overall benefit to consumers.

2.44. We also consider that an LNG system operator should also offer unused primary capacity on the customer's behalf to facilitate secondary trading. In cases where a customer chooses to go down this route, the customer should receive the revenue from the sale of that capacity<sup>27</sup>.

2.45. We consider that primary capacity holders would have the ability to trade their capacity for different time periods. For example, a market player that has contracted capacity rights for five years should be able to sell/transfer that capacity to another party as a whole or for a period of time within those five years. Such an arrangement would be particularly important where, such as is the case with LNG facilities, a large proportion of capacity is generally sold under long term contracts.

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<sup>25</sup> We intend 'facility users' to be the primary capacity holders.

<sup>26</sup> See Article 22 of the Gas Regulation.

<sup>27</sup> However, the LNG system operator may charge a cost reflective fee for providing this service.

2.46. Finally, in developing arrangements for secondary trading, all LNG system operators will need to ensure that contractual requirements (such as credit arrangements) do not unduly act as a barrier to the secondary trading of capacity and are non-discriminatory, transparent and non-proportionate (Article 15 (4), Gas Regulation).

## 3. Transparency and information provision to the market

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### Chapter Summary

This chapter outlines the legislative provisions and our preliminary views regarding information to be made public by an LNG system operator.

### Question box

**Question 7:** In addition to the information detailed in this chapter, is there any further information that LNG system operators should make publicly available?

3.1. This chapter provides our preliminary views on transparency and information sharing provisions for those seeking to invest in LNG facilities in GB through rTPA arrangements<sup>28</sup>. It outlines the relevant legislation and the benefits of transparency and information provision and details the information that we consider should be made available by an LNG system operator.

### Relevant legislation

3.2. Article 15 (1)(c) of the Gas Regulation states that an LNG system operator shall make relevant information public, in particular data on the use and availability of services, in a timeframe compatible with the LNG facility users' reasonable commercial needs, subject to the monitoring of such publication by the national regulatory authority<sup>29</sup>.

3.3. Article 17 (2) of the Gas Regulation states that LNG system operators shall implement and publish non-discriminatory and transparent capacity allocation mechanisms. We discussed these requirements in chapter 2.

3.4. Article 19 of the Gas Regulation outlines the transparency requirements for LNG facilities that will operate under rTPA arrangements. Specifically:

- Article 19(1) states that LNG system operators shall make public detailed information regarding the services they offer and the relevant conditions applied, together with the technical information necessary for LNG facility users to gain effective access to the LNG facilities.

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<sup>28</sup> For the sake of clarity, an exemption removes the requirement for a facility to comply with the requirements set out in section 19D of the Gas Act. In addition, an exempt facility, through Article 30 of the Gas Regulation, is exempt from all of the Gas Regulations information requirements that we have outlined below except that associated with Article 19(4).

<sup>29</sup> In the following chapter we set out details of the monitoring of such publication by Ofgem, as the national regulatory authority.

- Article 19(2) states that for the services provided, LNG system operators shall make public information on contracted and available LNG capacities on a numerical basis on a regular and rolling basis and in a user friendly standardised manner.
- Article 19(3) states LNG system operators shall always disclose the information required by this Regulation in a meaningful, quantifiably clear and easily accessible way and on a non-discriminatory basis.
- Article 19(5) states that to ensure transparent, objective and non-discriminatory tariffs and facilitate efficient utilisation of the infrastructures, the LNG facility operators or relevant regulatory authorities shall make public sufficiently detailed information on tariff derivation, the methodologies and the structure of tariffs for infrastructure under regulated third party access.

3.5. In addition, Article 19(4) states LNG system operators shall make public the amount of gas in each LNG facility, inflows and outflows, and the available LNG capacities, including for those exempted from third party access<sup>30</sup>.

3.6. The Gas Act (section 19(D)) also contains transparency provisions that must be met by an LNG facility. However, to avoid repetition, we have not listed these here. Importantly, exempt facilities are not required to comply with section 19(D) of the Gas Act.

3.7. ERGEG's 'Guidelines for Good Third Party Access Practice for LNG System Operators' also provides details of the information that LNG system operators should make available.

3.8. The proposed amendments to the Gas Act also include requirements about information that should not be released. Under proposed section 11C (1) and (2) of the Gas Act, the owner of an LNG facility will face restrictions concerning the release of information that it may have. Specifically, under:

- proposed section 11C (1), the owner of an LNG facility must take all reasonable steps to ensure that commercially sensitive information relating to the operation of the facility is not disclosed to:
  - a person in a way that discriminates against any other person or description of persons; and
  - an associated undertaking unless the disclosure is necessary to enable a transaction with that associated undertaking to take place.
- proposed section 11C (2), information which is obtained by the owner of an LNG facility from an associated undertaking for the purpose of, or in the course of, a transaction with that undertaking must not be used by the owner for any other purpose.

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<sup>30</sup> This Article also states that information shall be communicated to the transmission system operator, which shall make it public on an aggregated level per system or subsystem defined by the relevant points. The information shall be available at least daily. As outlined in the introduction of this chapter, Article 19(4) is applicable to exempt facilities.



## Benefits of transparency and information provision

3.9. Transparency obligations on market participants play an important role in the development of an efficient and effective energy market. Equitable and timely access to operational and market information can help facilitate more informed decision making by market participants. Improved transparency can reduce barriers to gas market entry and therefore can help the development of competitive markets. We therefore consider that all LNG system operators, whether operating their facilities under an rTPA regime or under an exemption, should look to make the maximum amount of information regarding the operation of the facility available to the market.

3.10. We consider that the information to be provided by the LNG system operator should be published on the relevant website and provided directly to existing and potential customers upon request. In addition, information should be provided to the transmission system operator, who, as required, shall make it public on an aggregated level per system or subsystem defined by the relevant points. This would enable potential users to more easily access LNG facility information, ensuring greater information transparency and consistency in the way such information is provided.

3.11. Further, we consider that the daily updating of information would be generally appropriate. However, relevant parties may wish to consider whether there would be merit in publishing this information on a closer to real time basis.

3.12. LNG system operators may also want to consider providing information about outages and other factors that might affect the services in periods beyond the current year.

3.13. In relation to 'available capacity', Ofgem considers that LNG system operators should provide information on the amount of capacity that has not been contracted i.e., the technical capacity of the facility less the capacity that has been contracted to be used.

## 4. Governance, monitoring and enforcement

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### Chapter Summary

This chapter sets out details of the relevant legislation as a result of the implementation of the Third Package in respect of the governance, monitoring and enforcement of rTPA at LNG facilities. It then outlines our views on monitoring and enforcement of the rTPA arrangements for LNG facilities in GB.

### Question box

**Question 8:** To what extent do you consider that market participants will be able to observe non-compliance with the legislative requirements by an LNG system operator?

**Question 9:** Taking into account your answer to question 8, what (if any) additional information to that set out in the previous chapter should LNG system operators provide to the Authority?

4.1. Governance, monitoring and enforcement obligations play an important role in the development of an efficient and effective energy market. Under the legal provisions discussed in the next sections, the Authority will have the ability to investigate and take action against an LNG system operator, whether operating its facility under an rTPA regime or under an exemption, when there is a reason to believe that it is not complying with the regulatory requirements of the regime under which it is operating.

4.2. This chapter provides our preliminary views on governance, monitoring and enforcement. In the following sections, we outline the relevant legislation and then detail our preliminary views regarding our approach to monitoring and enforcement.

### Relevant legislation

4.3. As a result of the implementation of the Gas Regulation and the expected transposition of the Gas Directive into GB legislation, the governance of LNG facilities will change, including with respect to the expansion and strengthening of the Authority's role in monitoring and enforcing relevant legislative requirements.

4.4. To ensure that LNG facilities are subject to the same enforcement and information provision requirements as other market participants that are set down in the Gas Act (sections 28 to 30F and 38), the owner of such a facility (as defined in 48 of the Gas Act) will be deemed a 'regulated person' under section 28(8) and will

be subject to 'relevant requirements' of the Gas Act as set out in the proposed schedule 4B of the Electricity and Gas Regulations<sup>31</sup>.

4.5. Under the proposed amendment to the Gas Act (section 34A), the Authority has been granted new powers to require regulated persons to provide information associated with monitoring compliance with respect to certain specified relevant requirements<sup>32</sup>. These relevant requirements include compliance with the provisions of the Gas Regulation pertaining to LNG facilities, including where applicable to exempt facilities and the transparency obligations (as required by Article 41(1)(i) of the Gas Directive).

4.6. Further, under the provisions of Article 41(10) of the Gas Directive, the Authority can require LNG system operators, if necessary, to modify their terms and conditions, including tariffs and methodologies, to ensure that they are proportionate and applied in a non-discriminatory manner<sup>33</sup>.

4.7. Ofgem also continues to have powers under the Competition Act 1998. Any abuses of dominance or anticompetitive behaviour can be investigated under competition law where it is appropriate.

4.8. For the avoidance of doubt, in addition to the relevant requirements under the Third Package, any LNG facility that operates under an exemption is required to continue to operate under the terms and conditions of that exemption.

## Approach to monitoring and enforcement

4.9. In practical terms, the proposed amendments to the Gas Act will make LNG facilities, whether operating under an rTPA regime or under an exemption, subject to the same monitoring and enforcement regime that have previously only applied to licensed persons. Under this regime, the Authority will be able to conduct investigations into companies that it considers may be in breach of the relevant legislation. Investigations can be undertaken on Ofgem's own initiative or on the receipt of complaints or on referrals from other regulatory bodies. Market participants should refer to our 'Enforcement Guidelines on Complaints and Investigations'<sup>34</sup> (the Enforcement Guidelines) for direction on our processes and policies regarding enforcement<sup>35</sup>.

4.10. The Enforcement Guidelines set out the information that we require to assess complaints and the criteria that we will use to determine whether to launch an investigation. The Enforcement Guidelines also explain the key stages of the

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<sup>31</sup> It should be noted that LNG facilities are not licensed under the Gas Act.

<sup>32</sup> Section 34(2A) sets out the relevant requirements.

<sup>33</sup> The provisions of article 41(10) have been transposed in the Gas Act in sections 19 (D) (8), 19 (D) (3) and 28 (1).

<sup>34</sup> "Enforcement Guidelines on Complaints and Investigations", Ofgem, 28 September 2007.

<sup>35</sup> In our 2011-16 Proposed Corporate Plan we stated our intention to consult on the revised Enforcement Guidelines. We expect this consultation to occur prior to the end of 2011.

investigation process and set out some key performance indicators that we will work to meet for acknowledging complaints and progressing investigations.

4.11. The aim of the Enforcement Guidelines is to provide greater clarity and transparency to our enforcement policies and practices, consistent with better regulation principles and the role that enforcement plays in meeting our wider duties.

4.12. The proposed new monitoring and enforcement provisions in respect of LNG system operators allow us to engage in a mix of proactive market surveillance, and to investigate and take action against market players where there is reason to believe that they are not complying with the relevant regulatory requirements.

4.13. To determine the relevant level of monitoring and enforcement activity that we will undertake two questions need to be considered:

- firstly, what is the likelihood that market participants will be able to observe non-compliance with the regulatory requirements; and
- secondly, what is the likely impact on the market when an LNG system operator does not comply with regulatory requirements?

4.14. We have taken the view that for many of the provisions, particularly those pertaining to information provision and transparency and consulting the market, any non-compliance is likely to be highly visible to the market. Given this, we will adopt a mix of monitoring and industry engagement (i.e., concerns or complaints raised by market participants) to determine whether or not LNG system operators are complying with the regulatory requirements.

4.15. For aspects of the regulatory framework where compliance will be less evident to the market and the impacts of any non-compliance are likely to be greater, we will engage with the relevant LNG system operators to determine what information they need to provide us. For example, we may request that an LNG system operator provide us with information on the process that it used to allocate capacity and whether there was any discrimination (the specific nature of the information requested is likely to depend on the capacity allocation mechanism used)<sup>36</sup>.

4.16. We note that it is up to each person operating or considering operating an LNG facility to seek legal advice (as required) to ascertain whether their activity falls within the scope of the relevant legislation. While Ofgem will approve (ex ante) a number of arrangements, such as auction arrangements for primary capacity, the majority of activities will be subject to ex post assessment. For those activities that have not been approved by Ofgem, we will not confirm whether a person carrying out an activity or proposing to carry out an activity is or will be compliant with the relevant legislation.

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<sup>36</sup> Any such request in the case of a facility operating under an rTPA regime would be in addition to the information to be provided as set out in Chapter 2.

# Appendices

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## Appendix 1 - Consultation response and questions

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1.1. Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document. (In particular, we would like to hear from LNG facilities currently operating in GB.)

1.2. We would especially welcome responses to the specific questions which we have set out at the beginning of each chapter and which are replicated below.

1.3. Responses should be received by 25 November 2011 and should be sent to:

- Francesca Caputo
- Economist, Markets
- Ofgem
- 9 Millbank, London, SW1P 3GE
- Email: [Europe@ofgem.gov.uk](mailto:Europe@ofgem.gov.uk).

1.4. Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website [www.ofgem.gov.uk](http://www.ofgem.gov.uk). Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.5. Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

1.6. Next steps: Having considered the responses to this consultation, Ofgem intends to release another document outlining our views on rTPA arrangements. Any questions on this document should, in the first instance, be directed to:

- Ian McNicol
- Senior Economist, Markets
- Ofgem
- 9 Millbank, London, SW1P 3GE
- Email: [Europe@ofgem.gov.uk](mailto:Europe@ofgem.gov.uk).

### **CHAPTER: One**

There are no questions in this chapter.

### **CHAPTER: Two**

**Question 1:** What level of consultation should an LNG system operator undertake when developing its main commercial conditions for the first time or when proposing amendments to its standard terms and conditions?

**Question 2:** Should an LNG system operator be expected to formally consult or test the market before changing existing services or offering any new services to the market? If no, please provide your reasons.

**Question 3:** Do market participants have any concerns with our preliminary views on capacity allocation?

**Question 4:** Can the Use It or Lose It (UIOLI) arrangements implemented by the LNG system operators in GB be improved to ensure greater utilisation? What lessons can we learn from current models to encourage greater use under an rTPA regime?

**Question 5:** Do market participants have any views on why secondary capacity trading has been used so little? Is access to unused capacity happening through mechanisms other than secondary trading and/or UOLI arrangements?

**Question 6:** Are there any mechanisms that could be established to facilitate greater use of secondary trading arrangements?

### **CHAPTER: Three**

**Question 7:** In addition to the information detailed in this chapter, is there any further information that LNG system operators should make publicly available?

### **CHAPTER: Four**

**Question 8:** To what extent do you consider that market participants will be able to observe non-compliance with the legislative requirements by an LNG system operator?

**Question 9:** Taking into account your answer to question 8, what (if any) additional information to that set out in the previous chapter should LNG system operators provide to the Authority?

## Appendix 2 - Auction arrangements

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The following information provides a list of the information that, at a minimum, needs to be submitted to Ofgem to allow us to make an assessment as to the suitability of proposed auction arrangements. Importantly, with the exception of the reserve price methodology, we consider that all this information should be consulted upon.

### General requirements

- Technical characteristics of the LNG facility, including LNG tankers included;
- The type of auction to be used (e.g. English, Dutch etc);
- Whether it is a closed or an open auction;
- The services being offered by the LNG facility, whether bundled or unbundled, and the length of those services;
- The auction platform (e.g. electronic, etc.), how interested parties can access it and who bears the cost of bidding in case of specific software requirements;
- The number of days notice (auction notice) that will be given to market participants before they have to submit their bids (e.g. auction notice to be published at least three months before bids can be submitted);
- Auction notice has to state:
  - The form in which bids must be submitted: e.g. in writing: letters, on line access to a platform, verbally, etc.;
  - The information to be submitted with the bid;
  - The currency in which bids can be submitted;
  - The closing date, time and address (physical or on-line) for submitting bids;
  - The amount of capacity that is being auctioned at each auction (where there is more than one auction) and whether there is any minimum lot size;
  - Duration of contracts;
  - The reserve price (if any) and the reserve price methodology;
- How and where information on the auction process will be advertised/disseminated (including what medium will be used) and for how long;
- Eligibility rules: who can be bid and which prequalification procedures are in place, including credit requirements (e.g. creditworthiness guarantees and deposits). Also suspension and re-instatement procedures should be specified;
- How and when information on winning bids will be released, including which information will be released to other market participants (e.g. prices at which the capacity was allocated, which amount of capacity was allocated at that price and for how long that capacity has been allocated);
- The language used in communication;
- The criteria for assessing winning bids, including any limits that may be applied on any other bidder, whether there can be partial bids and the process for allocating results in an outcome that is greater/less than the available capacity; and
- Anti-hoarding and secondary capacity arrangements: secondary trading and Use It or Lose It arrangements.



### **Rules of the auction process**

- Rules applying in case there are two or more bids displaying the same price, the same amount of capacity and the same contract duration;
- Disqualification rules: including dealing with collusion during the auction process;
- Information on when an auction can be cancelled or deferred and how any bids received will be treated;
- The maximum number of bids per market participant that can be submitted;
- How and why any bids may be rejected and the notification process in case that happens (e.g. non-compliant bids, etc.);
- Whether the auction is inclusive or exclusive of relevant taxes;
- Rules for re-submitting bids and in which circumstances this would be possible;
- What happens if the auction process does not allocate the total capacity that is for sale and whether the unallocated capacity will be made for sale again, etc.;
- Dispute management procedures in relation to auction results and payments;
- How to manage manifest error (human errors);
- How it will inform auction winners about outages and/or maintenance that may be required;
- Arrangements in place to ensure the confidentiality of the information received from market participants;
- Mechanisms to deal with force majeure; and
- Liability.

### **Payment rules and procedures**

- How and when invoices will be issued;
- How payments need to be made, including proposed payment security procedures including credit cover arrangements and whether this can be extended; and
- When any payment invoices are due and mechanisms to deal with late payments.

## Appendix 3 - Glossary

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### Anti-hoarding arrangements

Transparent mechanism(s) that allow unused capacity to be made available to the market so as to maximise the use of a facility.

### C

#### Capacity

Capacity means the maximum flow, expressed in normal cubic meters per time unit or in energy unit per time.

### D

#### DECC

Department of Energy and Climate Change.

#### Deliverability

Deliverability refers to delivering gas onto the transmission system.

### G

#### Gas Directive

For the purposes of this document this term refers to Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC.

#### Gas Regulation

For the purposes of this document this term refers to Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005.

### L

#### Liquefied Natural Gas (LNG)

The fluid state of natural gas, it can be obtained industrially by cooling down natural gas. Used essentially in dedicated tanker ships to transport gas overseas in a much reduced volume.

## LNG capacity

LNG capacity refers to the maximum capacity that an LNG facility can process. Importantly, for the purposes of this document 'LNG capacity' can also be referred to 'LNG facility capacity'. These terms should be considered interchangeable for the purposes of this document.

## LNG facility

A terminal which is used for the liquefaction of natural gas or the importation, offloading and re-gasification of LNG, and it includes ancillary services and temporary storage necessary for the re-gasification process and subsequent redelivery to the transmission system, but does not include any part of the LNG terminal used for storage.

Importantly, for this document, the proposed Electricity and Gas Regulations amending the Gas Act suggest that the words 'LNG import/export facility' should replace 'LNG facility'. These terms should be considered interchangeable for the purposes of this document.

## LNG importation terminal

LNG importation terminals are the terminals where LNG vessels can be offloaded.

## LNG system operator

A natural or legal person who carries out the functions of liquefaction of natural gas, or the importation, off-loading and re-gasification of LNG and is responsible for operating an LNG facility (see article 2(12) of the Gas Regulation)

Importantly, for this document we have used this term to capture the owner or the legal entity that is responsible for managing an LNG facility. Other terms captured by our simplification are 'LNG operator', 'facility operator' and 'operator'.

## **M**

### Market player

For the purpose of this document a 'market player' is either an LNG system operator or a primary capacity holder.

## **N**

### National Balancing Point (NBP)

The NBP is the virtual unified trading point of the GB gas transmission network.

### Natural gas undertaking

'Natural gas undertaking' means a natural or legal person carrying out at least one of the following functions: production, transmission, distribution, supply, purchase or storage of natural gas, including LNG, which is responsible for the commercial,

technical and/or maintenance tasks related to those functions, but shall not include final customers (Article 2(1), Gas Directive).

## **P**

### Primary market

Primary market means the market for capacity traded directly by the transmission system operator (Article 2 (22) Gas Regulation).

### Primary capacity holder

Primary capacity holder refers to an entity who has acquired capacity at an LNG facility directly from LNG system operator.

## **R**

### Regulated Third Party Access (rTPA)

Regulated Third Party Access (rTPA) refers to a system of access based on published tariffs and/or other terms and obligations, as determined by the relevant regulatory authority.

## **S**

### Secondary capacity trading/arrangements

This refers to mechanism(s) by which the primary capacity holders (or system users) make unused capacity available to other market participants.

### Supply

The sale, including resale, of natural gas, including LNG, to customers (Article 2(7), Gas Directive).

### System users

Term used in the legislation (Gas Regulation) to define primary capacity holders of LNG facility capacity.

## **T**

### Third Package

The Third Package, for the purposes of this consultation document refers to Directive 2009/73/EC of the of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC ("Gas Directive") and Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005 ("Gas Regulation").

### Third Party Access (TPA)

TPA means access by third parties to transmission and distribution networks, and gas and LNG storage facilities. The requirements of TPA are met either through a negotiated (nTPA) or regulated TPA (rTPA) regime.

### **U**

#### Use it or lose it (UIOLI) arrangements

Arrangements that ensure there are incentives to “use capacity” at a facility or otherwise “lose capacity” at a facility whereby any unused capacity is made available to the market.

## Appendix 4 - Feedback questionnaire

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1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments?

1.2. Please send your comments to:

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