bp

BP Gas Marketing Ltd
20 Canada Square
Canary Wharf
London
E14 5NJ

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Francesca Caputo
Markets, Fourth Floor,
Ofgem
9 Milbank
London
SW1P 3GE

Reference

<u>BP's response to Ofgem's Consultation on the rTPA regime for LNG facilities in GB</u>

BP welcomes the opportunity to respond to Ofgem's consultation published on 30 September 2011.

We have provided some answers to your consultation questions below and we hope you will find them helpful. If you have any questions please do not hesitate to contact BP using the details above.

Regards,

Ijaz Rasool

Direct: 02079484952
Main: 020 7948 5000
Fax: 020 7948 7844
ijaz.rasool@uk.bp.com

Consultation questions

Our responses to the consultation questions below relate to rTPA LNG terminals unless otherwise stated. Careful consideration should be given before applying additional obligations on exempt terminals which go beyond the obligations set out under the exemption order. We would also like Ofgem to be mindful that the imposition of a large number of additional obligations on market participants is likely to discourage investment in the GB energy market.

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?*

Under the Gas Act LNG facility operators operating under an rTPA framework may be required to consult the market before developing commercial conditions for access to their facility by Ofgem. Notwithstanding this formal requirement we believe that market consultation is important when developing commercial conditions to ensure there is a reasonable level of interest in the capacity on offer.

Developing terms and conditions that are attractive to market participants is important to ensure the facility operates efficiently and is commercially successful. Flexibility in responding to market participants changing requirements also makes commercial sense. This is likely to hold true for both regulated LFOs and exempt merchant LFOs.

We therefore, believe that an open consultation with market participants on areas such as the capacity on offer and the commercial conditions on which the capacity is offered should provide sufficient comfort to Ofgem that there is no intention to discriminate between potential facility users by the LNG system operator.

It should be noted that in some cases flexibility in accommodating market participant needs in developing commercial conditions may be limited. For instance, a facility may be built that can only accommodate specific sized LNG cargoes or a given quality of gas (this can occur where terminals are built as part of upstream projects). In this case it may be difficult to accommodate requests from market participants to allow them to bring in LNG cargoes or gas of a quality that the facility is unable to accept.

Notwithstanding the above it may be possible to accommodate requests by undertaking significant modifications to facilities, for instance, in the case of quality issues, by building a ballasting service but consideration is needed on how the cost of this additional investment is recovered.

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.*

With respect to offering new services it makes sense for facility operators to discuss and/or test new products/services they are proposing to offer with market participants before launching them. This ensures that a market for the products exists and that there is an expectation of a reasonable level of take-up. In terms of existing services, where there are contracts in place with market participants, any changes to these services will have to be negotiated under the terms of the existing contracts.

A requirement to consult with market participants where existing services are changed or new services introduced is particularly important for facilities where the market is not competitive. Where markets are competitive a formal requirement is not required as exempt merchant LFOs will seek to consult market participants anyway.

As noted above, facility specifications and operational constraints may mean that in some cases it is not possible to accommodate changes to commercial terms. It may be possible to accommodate some requests for additional services by charging an appropriate price to cover the cost of provision. However, as noted above, the design, geography, environmental or safety limitations may mean it is not possible to accommodate all requests.

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

We assume that Ofgem is referring to the allocation of primary capacity rather than the allocation of secondary/unused capacity. We support Ofgem’s view that LNG capacity allocation mechanisms should be market based. We also agree that auctions and open season are appropriate market based mechanisms.

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?*

In our view, the focus should be on ensuring that an effective secondary capacity trading mechanism is in place to allow maximum utilisation of unused capacity. Any UIOLI mechanism should only be used as a back stop, i.e. if secondary capacity trading arrangements are demonstrated to be insufficient or fail to ensure effective capacity utilisation.

More generally where the market is competitive, for exempt facility operators, the mechanism by which available capacity is sold to other market participants should be left to primary capacity holders. This ensures option value is not eroded.

As noted in our response to question five below, global re-gasification capacity is approximately double liquefaction capacity. Therefore, low utilisation rates are not an indication of poor access terms.

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?*

There are a number of factors explaining why secondary capacity trading has been rarely (if ever) used in GB. Firstly, worldwide there is around twice as much LNG re-gasification capacity compared to levels of liquefaction capacity. It is therefore unsurprising that some LNG facilities have very low utilisation rates. LNG capacity utilisation is a function of the GB price versus prices in the rest of the world. Where international prices are higher than GB prices, LNG cargoes are likely to be diverted to more profitable destinations resulting in a reduction in load factor.

In addition, if a primary capacity holder considers utilisation of capacity as uneconomic and therefore either prefers not to utilise the capacity or divert incoming cargoes to more profitable regions, it is unlikely that other market participants will come to a different view and seek to utilise this capacity.

Even where it appears capacity is not being utilised by the primary capacity holder, it is important to note that this does not imply the facility is being used uneconomically or inefficiently. LNG facilities are able to store gas, therefore, where tanks are full due to limited send-out, because of low spot prices for instance, it may not be possible to accept further deliveries of LNG. It is particularly important to take this into account in assessing the amount of capacity to make available to the secondary market.

Limited secondary capacity utilisation is also likely to be due to other, more accessible, ways by which market participants are able to utilise spare LNG capacity. Offering a virtual service, for instance buying a cargo ex-ship and selling back a monthly strip, or another suitable profile, at the NBP is already offered as an alternative. This avoids the need to pass terminal and operating risks down to the secondary capacity holder. Instead they can remain with the primary holder who prices this into the virtual service.

It is also interesting to note that BP has received only one expressions of interest to view our terms for access to available slots at the Grain LNG terminal since the secondary market was introduced. As noted above, this is likely to be due to market participants using ex-ship arrangements or taking a view that it is not economic to bring cargoes into GB.

BP continues to support secondary capacity mechanisms to ensure the capacity is used by market participants who place greatest value on it. However, it is important that any secondary trading mechanism does not to erode the value to primary capacity holders. As well as undermining existing investment this could also reduce incentives for further investment in LNG facilities.

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

Our response to question 5 shows there are legitimate reasons for the low utilisation of secondary capacity.

As noted above, whilst we support secondary trading mechanisms, when designing these mechanisms, in particular in developing the products to be offered, it is important to assess whether there is demand from market participants. Where demand exists products should be developed through discussions between primary capacity holders and interested market participants.

An important factor in deterring the level of use of secondary trading arrangements is the timing of when capacity is released to the secondary market. The earlier capacity is released the easier it is for other market participants to source and arrange for cargoes to be delivered. However, as noted this can severely reduce the option value to the primary capacity holder. For instance, the primary capacity holder may be able to arrange for cargos to arrive much quicker than other market participants who need more time. An earlier release of capacity to accommodate other market participants' requirements will reduce the option value the primary capacity holder has as they are now unable to utilise this advantage in sourcing LNG more quickly.

A requirement to release of capacity well in advance of utilisation of this capacity is likely to reduce the value from the project for the primary capacity holders and may reduce incentives on market participants to undertake further infrastructure investment. Therefore any secondary trading mechanism should also take into account specific characteristics and circumstances at each facility and ensure an appropriate balance is struck between primary and secondary capacity holders' requirements.

It is interesting to note that recent European legislation may reduce the incentive for market participants to participate in a secondary capacity mechanism. REMIT rules mean that facility users are unable to cover contracted positions due to unplanned outages before notifying the market. This is because the exemption only allows the facility operator to hedge any lost volume before the outage must be notified to the market.

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

BP is supportive of market transparency, which we believe provides a stimulus for increased trading activity. Information on services offered, terminal utilisation and available capacity is beneficial to market participants.

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?*

It should be straightforward to monitor non-compliance, particularly relating to provisions for information provision, transparency and consulting the market. We would expect market participants to flag to Ofgem any non-compliance.

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?*

Recent legislation and forthcoming guidance such as the LNG transparency guidelines due to be issued in Q4 2011 should ensures that all relevant information that market participants may want to make effective investment and trading decisions is in the public domain.

It is important to determine whether information market participants/regulators want to see published is already in the public domain, e.g. information on ship movements is commercially available via brokers (Tullet Prebon). Where this is the case Ofgem should not require facility operators to provide this information at no cost. More generally Ofgem should take into consideration the cost associated with releasing information compared to the benefit derived.