

25 November 2011

BY EMAIL

Ofgem
9 Millbank
London
SW1P 3GE

Attention: Francesca Caputo, Economist, Markets

Dear Ms Caputo

Consultation on the regulated Third Party Access Regime for Liquefied Natural Gas facilities in Great Britain – reference 126/11

Thank you for the opportunity to comment on the proposed Third Party Access Regime for Liquefied facilities in Great Britain.

South Hook Gas manages and owns the primary capacity at one of Europe's largest LNG terminals, the South Hook LNG terminal located at Milford Haven in South Wales (the SHLNG terminal). Our principal role is to handle liquid natural gas (LNG) cargo deliveries from the Qatargas 2 project in Qatar but we will also seek to maximise the use of the terminal capacity.

Commercial operations commenced in April 2010 and since then South Hook Gas has supplied natural gas into the UK National Transmission System (NTS) every day. In Gas Year 2010/11, South Hook Gas supplied 165,000 GWh into the UK market; representing c. 15% of the total UK demand. A portion of the gas processed was done under secondary regasification arrangements with secondary shippers. These figures demonstrate consistently high utilisation by South Hook Gas over that period, both for itself and under the secondary marketing arrangements.

To the extent that South Hook Gas holds spare capacity, it will also provide access to terminal capacity, through secondary capacity arrangements, to other LNG importers seeking to supply to the UK gas market. If we cannot sell spare capacity in the open market then capacity will be auctioned by the terminal operator to all registered terminal users.

An exemption from regulated Third Party Access (rTPA) was awarded to South Hook LNG Terminal in November 2004 which allowed South Hook Gas to purchase all the primary capacity in order to process LNG from Qatargas 2. The award of this exemption was considered essential for the Qatargas 2 project, and a necessity in order to secure the finance needed to build the terminal. We are therefore pleased to note that Ofgem is not seeking to alter the status of exemptions previously granted. We are further pleased to note that Ofgem continues to support exemptions from rTPA if required by future investors in new facilities. With this in mind, we believe that a rTPA regime should be consistent with, and comprise a part of, the wider regulatory and market arrangements for LNG terminal import and utilisation; our responses to the questions posed by Ofgem are made on this basis.

As a general comment, while South Hook Gas welcomes the opportunity to respond to the consultation, South Hook Gas does not believe that LNG facilities are being under-utilised, or that market participants are unable to gain access to capacity. On the contrary, South Hook Gas submits that the current arrangements promote flexible and market-based access and utilisation mechanisms which are, in turn, positive to diversity and security of supply.

Answers to specific questions:

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?

We submit that supply and demand triggers utilisation of terminals rather than UIOLI auctions. UIOLI auctions act as an effective backstop transfer mechanism to avoid under-utilisation of capacity, as they:

- (a) Allow unused capacity to be offered to market in a transparent and non-discriminatory way – capacity available for auction is advertised on bulletin boards and market participants have equal access to information.
- (b) Allow those parties that value LNG capacity most to gain access to it – market participants may take part in the auction process and capacity will be awarded to the ‘best’ bid.
- (c) Act as an effective anti-hoarding measure – primary capacity holders are unable to withhold capacity from the market.

Currently, available GB terminal capacity outstrips requirements and as a result the demand for access via UIOLI arrangements is low. In any event, the current UIOLI arrangements are an effective incentive for primary shippers to make spare capacity available. Changing UIOLI arrangements therefore will not necessarily have an impact on utilisation.

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 UIOLI arrangements?

To the extent that South Hook holds spare capacity, it will provide access to the SHLNG terminal to other LNG shippers seeking to supply to the UK gas market. South Hook Gas offers a suite of secondary capacity trading contracts which facilitate effective and flexible secondary capacity utilisation. Potential users of our capacity can:

- (a) Enter into a Master Regasification Services Agreement which allows the purchase of spare capacity and associated services directly from SHG on a spot, or long term, basis. These arrangements can be tailored to suit the LNG shipper, and therefore provide more flexibility (for example, when required, the ability to vary gas send out within day).
- (b) Purchase secondary capacity in the form of a South Hook Bundle (comprising berthing slot, temporary LNG tank storage space and redelivery capacity) directly from South Hook Gas or via UIOLI arrangements.

South Hook Gas has a number of secondary capacity trading agreements in place; it has already entered into a long term services agreement wherein a portion of primary capacity has been sold for a period of 25 years. South Hook Gas has also signed a number of spot master agreements which would allow access to the SHLNG terminal through the provision of regasification services by South Hook Gas.

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

South Hook Gas believes that the current regime is working effectively; no additional mechanisms are necessary. During Gas Year 2010/2011, the SHLNG terminal achieved a utilisation level of c. 70%, and when taking into account the current NTS constraint, utilisation was c. 90%. We consider this high utilisation level demonstrates the effectiveness of the existing arrangements.

Terminal capacity in the UK is often utilised via bilateral ex-ship LNG trades. Such arrangements are an additional – and effective and market-focused – mechanism to utilise terminal capacity.

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

While South Hook Gas is supportive of arrangements to improve transparency, they should only be considered where (i) demonstrably beneficial to improving access, (ii) do not conflict with existing commercially sensitive and/or confidential arrangements, and (iii) do not adversely affect the investment climate for new LNG &/or gas infrastructure.

There should be a clear rationale for publishing the information and this needs to be balanced against the principles above.

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?

South Hook Gas submits that it is critical for the effective operation of a liberal gas market that an independent regulator should monitor that all legislative requirements are being met.

We hope that you find these comments helpful.

Yours sincerely

A handwritten signature in blue ink, appearing to read "Rashid Al Marri".

Rashid Al Marri
General Manager
South Hook Gas Company Ltd.