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Dear Julian

Re. Modification Proposal UNC 0104 – Draft Modification Report

energywatch welcomes the opportunity to comment on the Draft Modification Report compiled for UNC 0104. This response is non-confidential and we are happy for it to be made publicly available alongside other responses.

Energywatch raised UNC 0104 after a number of large gas consumers raised concerns with us about the asymmetric nature of information on the availability of gas supplies which was affecting their ability to make rational commercial decisions during days when there are tight supply/demand conditions. This particularly manifested itself on a number of days during winter 2005/06 when wholesale gas prices rose substantially. It was not clear to the market whether further gas supplies could have been made available on those days and it was also not clear to large gas consumers at the same time whether they could or should be providing demand side response in the form of selling gas back to the market or through orderly interruption of their supplies. The lack of market information transparency would have been a likely probable cause of the extremely high wholesale gas prices seen on tight supply/demand days last winter. These high wholesale prices have fed through to the retail market, creating significant financial detriment for all gas consumers.

In order to avoid a possible repetition of these circumstances and, given that there remains considerable uncertainty about the potential for tight supply/demand conditions to occur on a given number of days during the peak winter demand period for the foreseeable future, with the adverse impact this also has for security of supply for all gas consumers, we raised UNC 0104.

The focus of UNC 0104 is on publication of data about the aggregate physical LNG in storage levels at LNG importation facilities on a day-after (D+1) basis. We have been asked why there should be a specific focus on LNG importation facilities. This is because these facilities are a potentially key source of gas supply on tight supply/demand days. Unlike beach gas which is effectively 'baseload' gas for GB demand, the level of gas flowing from a LNG importation facility is much more of a 'marginal' flow – meaning that the ability to flow more or less gas up to the physical flow capacity in tight supply/demand conditions could determine other interactions elsewhere in the market on the supply or demand side, including the potential need for demand side response from large consumers. If data about levels of LNG in storage is made available to the market, large consumers, shippers and suppliers are able to make more informed and rational decisions about how much gas could potentially flow from 'marginal' sources and accordingly determine their own commercial positions going forward, including their ability to self-balance, sell back gas or interrupt in an orderly manner.

The additional benefit of rational decision-making is that residual balancing by National Grid as the system operator should be eased further, reducing the costs to all market participants of system operation. These costs are ultimately paid by all consumers and so there should be a significant financial benefit to them of more efficient, economic balancing.

We now address some of the specific issues raised by a number of parties during the progress of UNC 0104 under the headings provided in the Draft Modification Report.

Extent to which implementation of the proposed modification would better facilitate the relevant objectives

Some comments indicated that no useful information would be provided through the implementation of UNC 0104 which will impact beneficially on the behaviour of large consumers or others. As already noted above, there are real benefits to all market participants of having information transparency in general and transparent **objective** information about LNG in storage levels in particular. It is not a feature of rational price discovery for market participants to 'guess' the level of supply which may be available from a particular supply source and come to rational commercial decisions on how they should react to that 'guess'.

We do not argue that the information sought through UNC 0104 will be used by all market participants on every day to inform their commercial decisions. However, on tight supply/demand days during the winter peak period, this information could become invaluable and allow a rational assessment of the state of supply which determines how they react. Market participants will be familiar with the recently implemented UNC modification 006 which was also raised by energywatch. We simply note the words of the Authority about information transparency in approving that modification, namely, that “In order for the market to operate efficiently, it is important that the arrangements in place are as transparent as possible. At the moment, some parties (notably producers) have access to information, which other parties (notably downstream suppliers, traders and customers) do not have. By allowing all parties access to near to real time subterminal information this should permit the market to operate more efficiently.” (page 8). While UNC 0104 does not seek near real time information, it does provide useful data to all market participants.

We believe that the following relevant objectives will be better facilitated by UNC 0104:

A11.1 (a) the efficient and economic operation of the pipe-line system

We have noted above that price discovery based on fact rather than guesswork improves the decision-making of market participants. In those circumstances, there are consequential benefits to flow from more rational commercial decisions resulting from the interpretation of that information. One particular benefit is that shippers and suppliers should take actions which improve their ability to self-balance. This can have the further beneficial consequence that there is less residual balancing required to be undertaken by National Grid, increasing the efficient and economic operation of the NTS, particularly on tight supply/demand days which would tend to be days when balancing costs may increase. The reduction of system operation costs will have a wider benefit for all consumers as they will be able to share in those reductions as the lower costs hopefully feed into the SO incentive schemes.

A11.1 (c) the efficient discharge of the licensee’s obligations under this licence

As well as meeting its licence obligation to operate an efficient and economic system, National Grid should be able to facilitate security of supply. If more rational commercial decisions are taken by market participants based on factual data about the availability of supply, we fail to see how this cannot help National Grid in achieving the

supply/demand balance in a more effective manner. This is much more preferable to market participants having to 'guess' whether there is available supply, how much there may be, and making decisions about their demand as a consequence which could potentially, on tight days, reduce gas safety and security headroom.

We do not agree with BG Group's comment that the factors driving demand are somehow wholly separate from those factors influencing supply. If that was the case, demand and supply would largely operate in separate vacuums, with little or no interaction between the two. Clearly, this makes no economic sense in the gas market. The availability of supply must, to some extent, drive the demand side to determine whether to increase, leave the same, or reduce, demand accordingly. Having factual information about a significant source of supply on tight supply/demand days in particular, when the interaction between the two is heightened even more, can only be beneficial to all market participants' decision-making. To claim that gas demand cannot be driven by the level of potentially available gas supply lends itself to irrational commercial decision-making.

We also do not understand the comment that one impact of UNC 0104 would be to adversely impact deliveries of LNG to GB or affect whether further LNG importation facilities would be built in GB, thereby impacting overall GB gas security of supply. This overstates any potential downside commercial impact of publishing the information being requested for the following reasons:

Firstly, the data is being requested on an aggregated basis. Secondly, it is being requested on a day-after (D+1) basis and so it will be indicative rather than precise about supply availability at LNG importation facilities. The publication of this data is not intended to increase price volatility in the market, nor do we believe that it will.

Thirdly, participants involved in the global LNG market, as in markets generally, are well aware that if there is a demand to be met, supplying that demand can provide a commercial opportunity. One reason why effective third party physical access became an issue at one LNG importation facility, Isle of Grain, last winter was because of the lack of knowledge about whether gas was available to flow from there to meet demand on tight days. As a result, there is now the ability for third parties to access unused berthing slots at Isle of Grain on a transparent basis. If, therefore, there is a profitable commercial opportunity for a third party to physically access an LNG importation facility in this way, we doubt very much that the party would turn down that opportunity. It should be noted that we refer above to **physical access**, rather than **information access** which is the subject of UNC

0104. Improved information access may assist improved physical access over time.

We do not believe that those who see the long-term commercial opportunity of investing in particular assets, including storage and LNG facilities, do not assess fully the financial and other risks involved in that investment. Every project carries various types of risk, including the potential for market rules, such as legislation or regulation, to change. No sensible investor would realistically expect market rules to remain entirely static for the full period of an investment. Does this mean that investors do not factor the impact of some change into their decisions? We doubt very much that potential investors are so easily scared away from particular markets by changes made from time to time to market rules.

A11.1 (d) the securing of effective competition (i) between relevant shippers and (ii) between relevant suppliers

We believe that the provision of data on LNG in storage at LNG importation facilities to all market participants, in a transparent and consistent manner through an established source (National Grid's website), will ensure that there is a level playing field as far as the dissemination of this particular information is concerned. That will allow participants to make rational commercial decisions and also improve their competitiveness as a result. We accept that there are other pieces of information which could be provided to the market, both on the supply and demand side. However, we consider that, as noted above, the specific information being requested through UNC 0104 may have a particular impact on tight supply/demand days. It will help market participants to better understand the commercial position regarding the availability of supply so that they can react on an informed basis.

We agree with BG Group that information transparency can significantly assist the operation of a well-functioning market, though there may be parameters and optimal boundaries between information transparency and commercial confidentiality which need further exploration. At the UNC Transmission Workstream on 2 November 2006, energywatch raised a topic, in conjunction with Poyry Energy, to consider how to explore these issues in more detail. We did so whilst recognising that a number of modifications seeking the publication of specific pieces of market information are currently proceeding through the UNC modification process, including UNC 0104. We believe that it would be more appropriate to allow due process to take effect for these modifications prior to undertaking a wider enquiry into the optimum level of information transparency. We

also recognise that there is nothing to preclude further UNC modifications from being raised in the meantime seeking access to further specific pieces of market data. Generally we consider that piecemeal change is less efficient and effective than a holistic approach to these issues.

While we accept that there is currently only one LNG importation facility which may be impacted if UNC 0104 is implemented, we do not believe that this creates a discriminatory impact, as the nature of the information requested is not **so** specific as to compromise the commercial confidentiality that any users of that facility may wish to maintain. The aggregate level (in kWh) of LNG in storage will be a single number which is unlikely to be directly attributable to any particular user at any particular time. We therefore do not accept that the data as requested will breach commercial confidentiality to a significant degree. As other LNG importation facilities are connected to the NTS, any residual risk to commercial confidentiality would decrease even further.

Implementation issues

We have been informed by National Grid that the provision of the aggregate level (in kWh) of LNG in storage is currently obtained by fax from the LNG importation facility which would initially be affected by the implementation of UNC 0104 as a result of existing contractual arrangements between National Grid and shippers. We therefore envisage no particular difficulties or additional costs involved in National Grid obtaining and publishing the data on its website. We do not expect that a systems solution for publication will be required immediately and that a workaround ought to suffice for the time being.

We believe that the suggested legal text provided in the Draft Modification Report meets the intent of UNC 0104.

Given the timescales in which UNC 0104 has progressed to date, we have been unable to obtain implementation within our preferred timescales prior to winter 2006/07. However, we would still hope that implementation is possible before the beginning of January 2007 to address the issues for which UNC 0104 was raised.

Advantages and disadvantages of implementation of the proposal

We have provided a number of arguments above for why we believe that the publication of the requested data will be particularly useful to all market participants on tight supply/demand days. We believe that

improving the commercial decision-making of market participants will be more conducive to rational price discovery than the failure to provide this data. We have already noted that there may be consequential benefits of improved commercial decision-making including more efficient and economic system operation and the lower costs of balancing by National Grid as participants are more able to self-balance. Improved transparency may provide lower and more rational prices over time, for the benefit of all consumers. We also consider that the particular data requested needs to be made available on a symmetrical basis if the full benefits are to be enjoyed.

We have tried above to address some of the issues which BG Group and others have suggested are disadvantages of UNC 0104. In particular, we wish to highlight the basis on which the information on storage levels is being requested. As the proposal states:

“Importation Operators, through their contractual arrangements with shippers, should therefore, seek to meet the minimum requirements of the Guidelines for Good Practice for System Storage Operators for information provision (which includes published numerical data on gas in store).” (our emphasis)

The Authority was asked by the UNC Modifications Panel to clarify whether UNC 0104 is within the scope of the UNC. The Authority's initial view, provided in its letter of 7 September 2006, states that:

“...as part of NGG NTS's obligation to ensure that it operates the NTS economically and efficiently and under the provisions of the UNC and its safety case, NGG NTS has an obligation to maintain the NTS within safe operating limits. NGG NTS can meet this obligation through the use of operating margins ('OM') gas as and when required.

In order to carry out its role as system operator, and to enable it to comply with the provisions of its safety case, NGG NTS contracts with parties for different services. An example of such a contract is where NGG NTS contracts with National Grid Grain regarding the use of OM gas in order to help maintain the system within safe operating limits. NGG NTS can meet this obligation through the use of operating margins (OM) gas as and when it considers this to be necessary.”

We believe that it is the **contractual relationship** which underpins the provision of information requested through UNC 0104. It is immaterial how a LNG importation facility is categorised. UNC 0104 seeks that good practice on information provision relating to storage levels should apply to LNG importation facilities. We also do not consider that the exemptions regime applicable to LNG importation facilities currently

prevents access to information about storage levels. There is nothing specifically excluding the provision of this particular information to the market.

We look forward to the UNC Modifications Panel and the Authority taking into account the detailed arguments outlined above in support of UNC 0104 when making a recommendation and decision on its implementation.

If you do wish to discuss our response further please do not hesitate to contact me on 0191 2212072.

Yours sincerely

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Head of Regulatory Affairs