

TRANSCO WORKSTREAM REPORT

"Title to Gas in LNG facilities"

Version 2.0

1 Background to the Modification Proposal

British Gas Trading (BGT) raised Modification Proposal 0571 to reflect the concerns held by itself and other LNG Storage Users that gas stored in LNG facilities was held by the Storage Operator rather than by the users themselves. This Report should be read in conjunction with the Reports previously submitted to the August and September Modification Panels.

2 Description of the Modification Proposal

The Modification Proposal was as follows:

"It is considered that this Proposal raises issues in eight key areas.

2.1 Definition of Title

In principle, it is proposed that for the purposes of holding title to gas in storage the gas in a storage facility at any time is divided into three components, as follows -

- i. Storage Users' gas, defined for each User at any time by that User's "gas-in-storage" providing this is not negative;
- ii. a share of the remainder deemed to be gas being held to the storage manager's account; and
- iii. all other gas in store at any time.

Storage Users would then be permitted to hold title to a quantity of gas which equals their gas-in-storage at any time providing this quantity is not negative.

In principle, this could be achieved by fairly simple changes to Code Section Z1.6, as illustrated in the Annex to this Proposal, but the concept of title to a proportion of the gas in a storage facility introduces a number of additional issues, not all requiring Code changes in the case of TLNGS' facilities.

Any subdivision of title to the gas in storage not "owned" by Users would be at the discretion of the storage facility owner(s), but it is strongly recommended that sufficient of this gas should be nominally "held" by the Storage Manager to allow for operating uncertainties. For example, Users' nominations are generally held whole (at present at least) at LNG Facilities, and to allow cost-effective operations TLNGS are only required to accept or provide the requisite amounts of gas at the NBP and to adjust each User's gas-in-storage appropriately.

TLNGS are however entitled, for example, to bundle the various nominations and can determine to manage their operations differently if, in their judgement, this is likely to prove economic. For example, (subject of course to physical limitations) TLNGS would be entitled to choose to inject or withdraw all the gas presented to

them on a day into and out of one site instead of into or out of the sites to which the nominations refer. The original Code concept of the Storage Manager was designed to allow a Storage Operator to make use of this flexibility by maintaining a "balancing account" at any storage facility, in three main cases -

- to enable the Operator to add to or reduce their own inventory when they choose to redirect a physical withdrawal or injection to a different site;
- to trade to alter the total gas injected or withdrawn on a Day; and
- to hold Users' nominations whole when the metered flows are different, by "accepting" all net differences.

Hence it is envisaged that the Storage Operator may, to this end, "own" some of the gas in a storage facility at any stage.

It is in the interests of the Users that apart from their own gas in store there is sufficient in store to facilitate normal operations. For the purposes of this Proposal such gas can be regarded as "cushion gas", required to ensure that pressures or physical quantities do not fall below safe operating limits or levels required to enable Users' overall gas-in-storage to be withdrawn at rates (and notice periods) to meet their contractual entitlements.

The Storage Operator would naturally be the logical owner of gas needed to offset boil-off from LNG facilities. His account would reduce as such gas is exported, and he would (as now) buy additional gas occasionally to replace the boil-off so as to ensure LNG Users' gas can be "held whole".

It is not necessarily desirable from the facility owner's viewpoint for all the "cushion" gas to be regarded as accessible for "operating flexibility". For example, some of the "cushion gas" may be recoverable in due course but only after "normal" storage operations cease or are scaled down: such gas is potentially an asset whose value can be realised in the short term by (for example) being used as collateral for loans. It would not be in Storage Users' interests to hinder such funding provided it does not jeopardise "normal" storage operations. Hence, it is proposed that the gas in storage not "belonging" to Users and not needed for short-term flexibility/operations is capable (at the owner's choice) of being separated for title purposes.

This permits "flexibility" in operations as at present, without jeopardising Storage Users' holdings or the owner's interests.

From time to time the quantity of cushion/native gas in a reservoir (or other storage facility) is reviewed. The above "three-part" model admits this. In effect any redetermination alters the quantity of gas in storage "owned" by the facility owner and any investors, and the model proposed reflects this by any adjustments falling to the owners' holding or (if the owner prefers) the Storage Manager's allocation.

2.2 Title of Gas at Entry/Exit to/from Transco's System

The Network Code assumes that title will move between Transco and the Storage Operator at the point of entry and exit. To this end, title to gas being injected into store should pass at System exit to the Storage Operator and then (where injected to increase a Storage User's gas-in-storage) to the Storage User, and title to gas being withdrawn from store should pass from the Storage User to the Storage Operator so that at the point of entry to Transco's System the title moves from the Storage Operator to Transco.

A possible outline is indicated in the Annex to this note in respect of proposed paragraph Z1.6.4.

2.3 Transco Emergencies

Storage Operators can be required to provide gas for the System in the event of an Emergency without needing to advise Users of any allocation between Users of the withdrawal and without needing Users' agreement.

It does not appear that any additional specific Code changes would be needed. Essentially, TLNGS would withdraw gas and provide an allocation as if Users had authorised a withdrawal. As with any withdrawal, title would move first from the Storage User to TLNGS and instantly from TLNGS to Transco.

2.4 Negative Gas-in-Store

Though title should be based on the defined "Gas-in-Storage" quantities, it is possible for these quantities to become negative. One example would be if a User has a series of trades for a day which would leave gas-in-storage positive but one of the "receiving" trades becomes cancelled.

Negative gas-in-storage then triggers over-run payments, and if not corrected can lead to termination.

The relevant rules should be left unaltered, but it is necessary for a Storage User to be entitled to hold title to a quantity defined at any time as their "gas-in-storage" (defined in paragraph Z1.3.1) providing this quantity is positive, or zero, if that quantity is negative.

2.5 User Termination

In the event that a Storage User is terminated, the title to any gas-in-storage held by that User should immediately revert to the Storage Operator, ie TLNGS in this case.

This permits the release of the User's capacity and gas-in-storage as happened with Enron's Rough capacity and gas when Enron "failed" in late 2001.

This can be achieved by an extension to paragraph 10.1.2 so that *"Upon a User's ceasing to be a User for the purposes of this Section Z.... Transco LNG Storage shall take Title to any gas-in-storage to which the User holds Title under paragraph 1.6"*

2.6 Option to Take Title or Not

The Code should allow the Storage User to take Title to Gas but also leave them the option of retaining the existing contractual structure. This is illustrated in the Annex in respect of the draft paragraph Z1.6.3 -

"The User shall be entitled to have Title to a quantity of Gas contained in a Transco LNG Storage Facility equal at any time to that User's gas-in-storage, provided that gas-in-storage is not negative. The User will advise Transco LNG Storage if he wishes to hold Title to his gas-in-storage in this manner. If the User so elects, his election may not be cancelled other than with the approval of Transco LNG Storage. If the User elects not to hold Title in this manner or does not advise Transco LNG Storage of his wishes then Transco LNG Storage shall have Title to and risk in the User's gas-in-storage."

This element of choice is essential if prompt benefit is to be available to those Users who desire to hold title to "their" gas, without requiring any Users to hold title if they do not so wish. This gives the choice of the proposed changes (or enhancements) or to retain the existing arrangements.

2.7 Risk

This Proposal would allow Users to hold title to "their" gas-in-storage but would leave "risk" as at present with TLNGS.

Essentially at present TLNGS "bear the risks", and the value of this is factored into the prices paid for the services. An area of potential significance is third-party risk, including risk to Transco's systems.

An alternative would be to offer title "with risk". This is simply much more complex, as it would involve "partitioning" any risk exposure.

Also, some Storage Users might conclude that the disadvantages of the transfer of risk are sufficiently material that they should not accept "title and risk", and it might be considered discriminatory and hence unacceptable for some Storage Users to have "title but no risk" and others to have "title and risk" without some "financial adjustment".

This may mean that the benefits (to Storage Users and the TLNGS) of allowing Storage Users to take title would be lost.

As transferring risk can be seen as devaluing the contract's value, it can be argued that the value of risk being held by TLNGS is already covered by part of the prices offered at auction and paid for late bookings, and that there is no convincing case for altering the "status quo".

2.8 Monitoring Information

Holding "title" to gas in store may not fully assuage concerns unless this is supported by assurance that sufficient gas actually exists in each store to enable that store to meet the requirements of the collective bookings.

Each customer can check their inventory via CALMS, but to have sufficient security and confidence there needs to be a composite list of total ownership of gas in store subdivided between the users and the Storage Facility Operator. The

distribution of ownership of the gas will at any stage be commercially confidential. It would therefore be wholly inappropriate for a full tabulation of such ownership to be published or accessible by all interested parties. Yet each interested party should have means of ensuring their particular interests and rights are not in any way in jeopardy, or the comfort of third-party checks that sufficient gas is accessible for all valid interests to be protected.

It is therefore proposed that CALMS should be adapted to show overall gas-in-store ownership for each LNG Facility subdivided merely between LNG Users (in total) and others holding title to gas (also in total).

The intent is to demonstrate that, in addition to the necessary cushion gas, sufficient gas is in store to enable the users' withdrawal entitlements to be met. This would therefore need to be supported by an indication of the minimum inventory needed in each facility to enable five consecutive days' withdrawal at the Facility's Total Storage Deliverability. It is proposed that this additional information be provided each year in TLNGS' Annual Storage Invitation.

The additional information envisaged in TLNGS' Annual Storage Invitation would require an additional clause in Code paragraph Z3.1.3. The change to CALMS appears not to be a 'Code change'."

3 Sub-Group Discussion

The Planning and Security (including Storage) (PSS) Sub-group of the NT&T Workstream discussed a further document supplied by the Proposer at its October meeting,. It was agreed that some of the concerns expressed at previous meetings had been addressed but not all. The Proposer therefore agreed to gain a legal view on the following issues:

- Can the concept of Title apply if the Storage Operator uses its present multi-site injection flexibility?
- Can Title be transferred where injection nominations of one Storage User cancels out the withdrawal nomination of another Storage User ie a physical gas flow would not take place?
- Do insolvency laws allow the Storage Operator to take Title to gas stored by a Storage User in default?

The Proposer also agreed to prepare business rules in order to assist legal drafting.

The Proposer had anticipated that further review would be required and the Sub-group agreed that the Proposal should remain with the Workstream.

4 Recommendation.

The recommendation to the Modification Panel is therefore:

That Modification Proposal 0571 should remain with the NT&T Workstream.