# Canatxx Shipping Limited

John Bradley
UNC Panel Secretary
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Dear John

***Canatxx Shipping Ltd Response to UNC Modification Proposal 0246, 0246A and 0246B - Quarterly NTS Entry Capacity User Commitment***

Canatxx Shipping Ltd appreciates the opportunity to respond to UNC Modification Proposals 0246, 0246A and 0246B. We do not support any of the versions of this Modification for reasons we set out below.

First, however, we would like to provide some background in relation to the proposed Canatxx salt gas storage facility at Fleetwood.

Canatxx has been developing this facility for more than 10 years during which time we have invested more than £50 million. Our first planning application was submitted to Lancashire County Council in 2003, with a further application in 2005, non determination was reached in 2005 on the second and it went to a Public Inquiry. The Inquiry did not go in favour of the Planning application with a refusal from the Minister in 2007 and so Canatxx had to reapply. This has been done and a revised Planning Application was registered with Lancashire County Council in February 2009, Canatxx  are confident that this will be approved later in 2009 as all the issues identified in the Ministerial letter have been fully addressed.

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Canatxx Shipping Ltd purchased capacity in the September 2006 QSEC ahead of Planning permission due to the long lead times (some 4 years) associated with NTS capacity expansion projects. We purchased capacity from October 2010. Given the planning delays, we now believe that we will not flow gas into the NTS before end 2012. Notwithstanding that delay, the fundamentals of the Canatxx project have strengthened since 2006 as a result of a number of developments:

- Inability for other storage projects to go ahead, also due to planning difficulties, with only 3 new gas storage projects completed in the UK since 1983
- Forecast increase in NTS gas demand due to the closing of nuclear and coal electricity generation plants
- Need for CCGT generation units to provide back-up to intermittent offshore wind which means an increasing requirement for highly flexible gas storage, as provided by the Canatxx facility
- Increasing requirement for spot LNG cargoes to be purchased from 2013 onwards, these will be difficult to secure for the UK and its consumers without additional storage capacity, in particular storage with high injection rates, thereby enabling cargoes to be absorbed quickly. This is a key characteristic of the Fleetwood facility.

In addition, since 2005 when the price for capacity at Fleetwood was established there has continued to be a major decline in gas flows from St Fergus and Teesside. This decline is releasing significant capacity for new gas to enter at Fleetwood as a significant portion of the St Fergus and Teesside gas would have used the same pipeline assets as the Fleetwood gas. The proposal from National Grid to transfer some redundant parts of the northern NTS to use for transporting $CO_2$ northwards is something that was not foreseen in 2005. In addition, as a result of the recession, we have seen a dramatic fall in the cost of steel. Given this, we believe that if the calculations for the cost of new capacity for Fleetwood were repeated now, it is likely that the Canatxx gas could be accommodated at much lower cost.

We are not, however, suggesting that the cost of capacity at Fleetwood is adjusted to reflect changed circumstances. In the same way, we believe that the Milford Haven pipeline projects may have cost over £1 billion whereas the NPV value was around £400 million. We are not suggesting that the Milford Haven shippers should be asked for an additional contribution of, say, £300 million to reflect these higher costs.

Given the above, the Canatxx Shipping Ltd position is that the UK regime should encourage new gas storage projects and the UNC that applied in 2006 when

Canatxx Shipping Ltd bought capacity should not have its fundamental principles amended retrospectively.

Canatxx Shipping Ltd believes that BGT's Modification proposal 0246B correctly sets out the importance of not making fundamental changes to a capacity sale and purchase contract entered into in 2006. BGT says:

"Existing capacity holdings were bought by Users on the basis of the rules, and associated costs, in place at the time of purchase. 0246 would change (possibly significantly) the costs faced by Users in respect of existing capacity holdings, without a corresponding increase in the value of that capacity. It is likely that in some cases, had Users known about the proposed increase in cost, this would have changed their decision about what capacity to purchase, and how much they were prepared to pay for it"

In the case of Canatxx Shipping Ltd, both the 'Key Issues' are such that they fundamentally change the basis of the 2006 contract in a way that could not have been foreseen in 2006. Had Canatxx Shipping Ltd believed that the contract would subsequently be changed in such a fundamental way, we would not have bid for capacity. Our understanding is that both the Key Issues are not new but have applied for many years. The decline in northern NTS utilization and creation of redundant assets was not foreseen, the overspend on Milford Haven was not foreseen. It is unfair, arbitrary and discriminatory to target one element of the regime as a result of 2006 actions without targeting other issues that are equally unforeseen.

This means that, in respect to "Key Issue 1", the ability to defer taking capacity should remain and hence we reject the proposal related to changing the arrangements for provision of credit on a rolling twelve month basis. New ASEPs who have bought capacity but have not yet flowed gas should be able to defer starting to pay for capacity as they always have been able to do. In the long run, National Grid will get the income, it is a timing issue.

In addition, in respect to "Key Issue 2", there should be no change to the credit arrangements that applied to capacity booked by shippers prior to 2009.

Going forward, we believe that the UNC could be amended to change the rule related to deferred capacity for new projects (Key Issue 1) as the UNC has always been able to make changes that impact future business.

Similarly, in relation to the credit arrangements going forward, we also believe that it could be argued that all future booking of capacity should require additional credit, whether at a new or existing terminal. As above, it may be possible to agree a change from this point forward.

We did not put forward another version of this Modification making these suggestions because we believe that an Ofgem Impact Assessment is the appropriate vehicle to discuss all the options. By way of input into that document, we also believe the following:

- The requirement to provide security prior to the QSEC auction will make it very difficult, if not impossible, for new independent gas storage projects to reach financial close. Banks will not provide credit before the project is "viable", a project cannot reach that milestone without an Entry point and capacity, thereby creating a "chicken and egg" scenario. There is no certainty that capacity becomes available in a QSEC auction as there are a number of scenarios that would cause capacity not to be fully allocated:

    - Ofgem does not approve the allocation because National Grid has, in error, incorrectly applied the methodology for the auction
    - Another shipper has complained that the methodology has not been applied correctly
    - National Grid has decided not to put forward the allocation proposal (for whatever reason)
    - The shipper has incorrectly bid and has failed to pass the NPV test for the necessary volumes

  The above situation regarding finance will mean that the only way independents could bid would be by the use of cash, anyone who has developed a project will know that surplus cash to do this is very rare. This would create a position where, going forward, projects could only be developed by large incumbent market players, this is not in the interests of consumers .

  We believe that for new gas storage facilities there should be a window to provide credit, say 6 months from the auction date, which is an extension of around 3 – 4 months from the present (auction September, allocation end November). This would be reasonable and would allow financial close to be managed. We do not believe that National Grid would make any material financial commitments in this additional 3 – 4 month period , if they had to, they could reasonably request that the shipper provides funding to cover this (as per Preliminary Works Agreements).

- Ofgem and National Grid should discuss a change to the NG Licence to provide the necessary flexibility for new gas storage projects

We hope you find these comments helpful.

Yours sincerely

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On behalf of Canatxx Shipping Ltd