Department of Energy & Climate Change

Future Management of the Compulsory Stocking Obligation in the UK

Publication date 4th April 2013

Department of Energy & Climate Change

1. **The UK holds emergency stocks of oil and refined products (such as petrol, diesel and aviation fuel) to release to the international market in the event of a supply disruption that requires such market intervention to bridge the gap in supply. This is to comply with obligations set both by the European Union (most lately revised in the Oil Stocking Directive 2009/119/EC and transposed through the Oil Stocking Order 2012) and the International Energy Agency (set out in the International Energy Program contained in the Governing Treaty).**

2. **The UK has released stocks three times, as a result of international agreement between IEA and EU Members. This was firstly in the lead up to the Gulf War in 1991, following the impact of Hurricanes Rita and Katrina in the US in 2005, and during civil disruption in Libya in 2011. As we become more reliant on imports, the level of the obligation in the UK will increase. This is set in legislation at whichever volume is higher; 90 days of average net daily imports, or 61 days of average daily inland consumption.**

3. **The UK has always met these obligations through directing companies to hold stocks. Section 6 of the Energy Act 1976 allows the Secretary of State for Energy and Climate Change to give directions to companies producing, supplying or using crude liquid petroleum or petroleum products within the UK market, requiring them to hold minimum levels of oil stocks.**

4. **This consultation is in two parts:**

   <u>Part One</u> considers whether the current approach to managing the compulsory oil stocking obligation in the UK meets our objectives for a resilient stockholding policy in the UK, and sets out a proposed alternative model through establishing an industry operated Central Stocking Entity in the United Kingdom.

   <u>Part Two</u> calls for evidence on the costs, benefits and feasibility of introducing such measures in the United Kingdom. This includes an Annex setting out information on the approach taken in other IEA and EU Member States to compulsory stockholding.

Contents

General information

Purpose of this consultation

The UK is required to hold emergency stocks of oil products to release to market in the event of short term oil supply disruptions, known as the compulsory stock obligation (CSO). Currently Government issues individual directions to business. There are concerns the present system creates under investment in adequate storage, posing a long-run risk to resilience, and may harm the ability of the UK to meet the CSO in the long run.

The policy objective is to ensure that the CSO continues to be met in the future in the UK, as the overall obligation increases in response to declining UKCS production and to ensure the UK holds and can deploy sufficient emergency stocks effectively to mitigate the detrimental impacts on the UK or any oil supply disruption. This supports Government's security of supply objectives.

Issued: **4 April 2013**

Respond by: **12 noon 7 June 2013**

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Consultation reference: URN **13D/042** – Future Management of the Compulsory Stocking Obligation in the UK

Territorial extent:
This consultation covers the United Kingdom, emergency oil stocks are a reserved matter and the oil stocking obligation will continue to cover the UK. Energy generally is devolved in Northern Ireland but oil stocking is not.

How to respond:
Your response will be most useful if it is framed in direct response to the questions posed, though further comments and evidence are also welcome.

Responses should be emailed to deccdownstreamoilteam@decc.gsi.gov.uk.

Hard copy responses can be sent to

Energy Resilience
Department of Energy & Climate Change,
Third Floor Area E
3 Whitehall Place,
London, SW1A 2AW
Tel: 0300 068 2924.

Additional copies:
You may make copies of this document without seeking permission.

Other versions of the document in Braille, large print or audio-cassette are available on request. This includes a Welsh version. Please contact us using the above details to request alternative versions.

Confidentiality and data protection:
Information provided in response to this consultation, including personal information, may be subject to publication or disclosure in accordance with the access to information legislation (primarily the Freedom of Information Act 2000, the Data Protection Act 1998 and the Environmental Information Regulations 2004).

If you want information that you provide to be treated as confidential please say so clearly in writing when you send your response to the consultation. It would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded by us as a confidentiality request.

We will summarise all responses and place this summary on our website at www.decc.gov.uk/en/content/cms/consultations/. This summary will include a list of names or organisations that responded but not people's personal names, addresses or other contact details.

Quality assurance:
This consultation has been carried out in accordance with the Government's Code of Practice on consultation, which can be found here:
http://www.bis.gov.uk/files/file47158.pdf

If you have any complaints about the consultation process (as opposed to comments about the issues which are the subject of the consultation) please address them to:

DECC Consultation Co-ordinator
3 Whitehall Place
London SW1A 2AW
Email: consultation.coordinator@decc.gsi.gov.uk

The Compulsory Stocking Obligation in the UK

1.1 *The UK is required to hold emergency stocks (supplies) of crude oil and petroleum products to release to market in the event of short term oil supply disruptions to bridge the gap in supply. These are separate quantities of oil and oil products to the normal operating stocks within the market. We hold these stocks to comply with international requirements set by the EU and the International Energy Agency (the same stocks are used to meet both obligations).*

1.2 *As an EU Member State, under the terms of the Oil Stocking Directive1 ("the EU Directive") we are required to hold oil stocks at the higher of 90 days of average net daily imports or 61 days of average daily inland consumption in order to mitigate the effects of a supply disruption. For the UK, as an oil producing country, this means that we have to hold 61 days of average daily inland consumption which represents a higher volume. As UK crude oil production declines, the obligation will increase and will eventually be based on 90 days of daily imports[2].*

1.3 *As a member of the International Energy Agency (IEA) the UK also commits under the International Energy Program in the Governing Treaty to:*

- *Maintain emergency oil reserves equivalent to at least 90 days of net oil imports*
- *Provide programmes of demand restraint measures to reduce national oil consumption[3]*
- *Participate in oil allocation among IEA countries in the event of a severe supply disruption*

1.4 *Currently the UK meets these obligations through placing obligations on individual companies who produce or supply substantial quantities of refined product into the UK using powers under the Energy Act 1976 and the Oil Stocking Order 2012. Details of individual obligations are sent to companies on a quarterly basis, and calculated based on companies' market share. This is done by reference to the companies' supplies to market over a 12 month period, beginning 18 months before the obligated quarter and ending six months prior to the obligated quarter. More detail on the way in which the obligation is calculated can be found in the guidance notes (https://www.gov.uk/government/publications/emergency-oil-stocking-international-obligations).*

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[1] Council Directive 2009/119/EC of 14 September 2009 imposing an obligation on Member States to maintain minimum stocks of crude oil and/or petroleum products.

[2] Under the terms of the EU Directive, 10 per cent of stocks are deemed to be inaccessible (e.g. through being held in tank bottoms). Accordingly, Member States are in effect required to hold just over 67 days of net daily consumption, or 99 days of net imports.

[3] More information on the demand restraint measures available to DECC in the event of a supply emergency can be found at (link).

1.5 *Obligated companies fall broadly into three categories which are i) refiners ii) importers and financiers or iii) significant traders although to be obligated they must provide over 50,000kt oils to the UK market.*

- *Refiners are those companies whose business is to produce oils from crude oil, the stocks they hold toward the obligation are likely to be varied (depending on refining output) while the businesses are likely to hold significant stocks in order to feed the refining process – they are obligated at 67.5 day's supply and there are approximately 10 companies obligated in this grouping.*
- *Importers and financiers are those companies who do not produce oil products but who supply the market from outside UK-production sources, usually in order to supply direct to retailers or in order to supply their own business needs (as with the airline industry) – they are obligated at 58 day's supply and there are approximately 12 companies obligated in this grouping.*
- *Significant traders are those remaining companies who will at times hold legal right to considerable oil stocks but may not supply direct to retailers (this may include ticket holders or those who organise trades for others) – they are also obligated at 58 day's supply and there are approximately 8 companies obligated in this grouping.*

How the obligation is determined and managed

1.6 *Only companies producing or importing substantial volumes of oil are obligated. To receive an obligation, companies must be supplying at least 50 000 tonnes of obligated oil products to the UK market, either by importing these products or producing them through the refining process. If companies source their oil from other companies in the UK market they do not incur an obligation to hold stocks.*

1.7 *The level of the obligation of an individual company is different depending on whether the company is a refiner or non-refiner. (Non-refiners subject to the obligation could be importers and significant consumers, such as airlines). This differential was last reviewed in 2006 and currently stands at 9.5 days, meaning that refiners are required to hold 67.5 days of stock (crude oil equivalent), whereas non-refiners are required to hold 58 days of stock. The level of the differential is being kept under review, and as part of this consultation DECC is seeking views on whether this should be revised, considering the current market for refined products and relative market share of different types of obligated company (See Part Two).*

1.8 *Under the terms of the Oil Stocking Order 2012[1] and as required by the EU, DECC must also ensure that 22.5 days of stock of the UK's most critical fuels – petrol, gasoil & diesel, and aviation fuel - are held as finished products so as to ensure oil can be made available quickly in the event of a supply disruption. Companies can meet this part of the obligation through stock held in tanks, through national tickets, or international tickets on stock (more detail on these arrangements is set out below). The remainder of the obligation can be met through crude oil or any other of a wide range of petroleum products held either domestically or internationally.*

1.9 *DECC collects information from each of the obligated companies on the stocks held to comply with the obligation, and issues reports to the European Commission* *(http://ec.europa.eu/energy/observatory/oil/stocks_en.htm) and to the IEA (http://www.iea.org/netimports.asp) monthly. Due to the need to collect accurate data, these reports are required by the IEA and EU after a two month lag.*

1.10 *The International Energy Agency (IEA) constantly monitors the oil market, collecting data on supply, demand, balances and stocks to provide the monthly Oil Market Report. The IEA Secretariat and member country representatives also participate in peer reviews of emergency preparedness of IEA member countries every few years, with key recommendations made public*[4]*. Every two years, the IEA also carries out a series of workshops and exercises to train and test policies, procedures and personnel. This is to test the decision making process, review policies, and ensure readiness to act quickly and effectively. The IEA publish oil reserves of member countries on their website monthly. The EU also publish data on their website monthly relating to member states stock holdings, and from January 2013 may also undertake reviews of Member States' emergency response preparedness.*

Options for meeting the obligation

1.11 The UK is one of the few countries to manage the obligation through directly obligating significant producers and suppliers of oil. Companies must be compliant at all times throughout each month in the products that they are specifically obligated in, they must also be compliant for the whole obligation period. The full cost of meeting the obligation is borne by companies, and passed onto consumers in prices paid for products.

1.12 Companies have flexibility in how they can meet the obligation and have four main approaches:

- **Holding stocks themselves within the UK** (usually on site at a refinery / terminal or in a dedicated storage facility). There are currently no restrictions on the location of compulsory stocks within the UK, though companies report monthly to DECC on the location of all the stocks held towards the obligation.

- **Holding stocks through a third party within the UK** a company may arrange for some or all of the stocks held in compliance with a Direction to be held on its behalf by another company in the UK – a "UK ticket arrangement". The company providing these stocks must have surplus stocks or stockholding capacity as stock can only be counted towards an obligation once. The contractual arrangements between the two companies must ensure that stocks will be physically accessible and available at all times.

- **Holding stocks themselves outside the UK:** companies can arrange for some or all of the stocks held in compliance with a Direction to be held at their facilities in other EU Member States – an "international storage arrangement". These arrangement must be

[4] The last review of the United Kingdom was in 2010 http://www.iea.org/publications/freepublications/publication/name,3940,en.html

authorised in advance by DECC and by the competent authority of the State in which the stocks are to be held. DECC has powers under Sections 1 to 3 of the Energy Act 1976 which would enable the Secretary of State to require repatriation of oil stocks held towards our international obligations in the event of an emergency.

- **Holding stocks through a third party outside the UK** companies can make arrangements with other companies in other EU Member States to hold stocks on their behalf – an "international ticket arrangement". These arrangements need to be authorised and DECC needs to be satisfied that stocks held in another EU Member State will remain physically accessible and available, and that arrangements are in place with the relevant Government.

1.13 Based on figures for the first quarter of 2013, around 30% is held in tickets in other European Member States. Tickets can only be arranged with companies outside of the UK in EU Member States, and are subject to the approval of DECC and the equivalent administration in the other Member State. Table One sets out further information on how the obligation has been met for Quarter 1 2013.

1.14 UK companies can also hold compulsory stocks on behalf of companies from other EU Member States. These arrangements must be authorised in advance (Article 9 of the Oil Stocking Order 2012). The UK also has an agreement with New Zealand, under which UK companies can hold stocks on behalf of the New Zealand Government, subject to agreement of the UK Government. Under the EU Directive, it is not possible for obligated companies to hold UK stocks outside of the EU[5].

[5] Price reporting on tickets is complicated by the availability of contracts at different lengths. DECC does not hold a dataset on ticket prices, but we have modelled indicative costs in the Impact Assessment using information provided by brokers commercially in confidence. Costs used in examples are indicative and should not be relied upon when considering potential ticket prices in the UK.

Table One: Q1 figures for stocks held by product and location

Q1 2013 Data	Motor Gasoline	Gas/Diesel Oil	Kerosene type jet fuel	Any Oil Total	Total
UK CSO (thousand tonnes COE)*	**983**	**1,985**	**784**	**7,748**	**11,500**
CSO held Abroad (thousand tonnes COE)	259	639	208	2,570	3,676
% CSO held Abroad	**26%**	**32%**	**26%**	**33%**	**32%**
CSO held in UK (thousand tonnes COE)	724	1,346	577	5,177	7,824
% CSO held in UK	**74%**	**68%**	**74%**	**67%**	**68%**
Stock held in UK for other MSs	16	262	53	65	396
Total Stock in UK (as a % of CSO)	**75%**	**81%**	**80%**	**68%**	**71%**

*based on obligation set on individual companies, not UK obligation

The Ticket Market

“Ticket Trading” occurs over the counter through brokers and directly between industry parties. This system offers additional flexibility to companies in how they meet the obligation and also enables non-obligated companies holding stocks to put this to commercial use through selling tickets.

Indicative Example:

As part of Company A’s overall obligation, they are required to hold 8kt of diesel as emergency stocks. When planning the next month’s business, they find that they are likely to be short of 2kt of product. They approach a broker, who identifies that company B has surplus stocks of diesel. Company B could be a company that does not have an obligation or an obligated company with excess stock. The broker, working with Company B, is able to offer ticket terms to Company A, at a given cost for a month, to hold these stocks on their behalf. For example, this might be for $4 per tonne per month.

These arrangements are then put to DECC for authorisation. If Company B is based in another Member State, DECC would seek confirmation that the administration in that Member State was also content to approve the transaction.

Should the UK be participating in a stock-draw, DECC would inform Company A of the impact on their obligation. Using the above example, if this was to make 1kt of diesel available to market, Company A would have the option of either directly tendering stocks that they held in physical storage or they could inform Company B and ask them to make this stock available to market. Company A might also choose to buy this stock at the price stipulated in the ticket contract and to sell it on to consumers directly.

The supply of tickets for middle distillate products such as diesel and aviation fuel is likely to reduce within the EU, as demand for these products is tending to outstrip production in most Member States.

Process for stock-draw

1.15 If the UK is participating in a stock release following a decision by the Governing Board of the IEA, or an authorisation by the European Commission, DECC temporarily reduces the level companies are obliged to hold and notifies them by email. In response companies are required to make excess stock available for purchase on the market either directly or through cancelling the contractual arrangements ('tickets') they have with third parties who hold stocks on their behalf. Companies are required to report to DECC on the efforts they have made to sell stocks. It is a criminal offence for companies to hinder the release of stocks by not making these available to the market. Following a stock-draw, the UK will develop a plan for re-stocking in consultation with the IEA, the EU and the obligated companies.

1.16 DECC is the lead Government Department for coordinating the UK's response to major incidents to key energy services and industries. The Energy Resilience team serves as the National Emergency Strategy Organisation for the purposes of energy, and is responsible for maintaining and implementing emergency response measures. This includes oil supply disruptions and supervising guidelines for companies to follow with regard to security of natural gas supplies. The team collects data and monitors the domestic oil and gas markets and industry's compliance with the compulsory stockholding arrangements. Any decision to release stocks in the United Kingdom is led by the Secretary of State for Energy and Climate Change, in consultation with Cabinet Colleagues.

1.17 The IEA has only used the stock release mechanism on a global scale three times. This was (a) in the build up to Gulf War in 1991(2.5 mb/d released) ; (b) after Hurricanes Rita and Katrina damaged offshore rigs, pipelines and refineries in the Gulf of Mexico in 2005 (2mb/d released for 30 days in total); and (c) the disruption of Libyan supplies in 2011 (1.6 mb/d in total)[6]. These figures represent the total amount released globally to the international market. The UK reduced the obligation for individual companies to release stocks on each of these occasions. The amount that the UK released was agreed with the IEA, and reductions in individual companies obligations apportioned by DECC.

1.18 The EU Directive recognises that there may be circumstances where Member States may be required to release stocks domestically to react quickly to cases of particular urgency or in order to meet local crises (see Article 20). For example, these could include disruptions in the supply of natural gas which require fuel switching. In such an event, the European Commission must be informed, the UK may temporarily hold stocks lower than required by the Obligation, and the Commission shall set a time frame for stocks to be brought back up to the required levels.

1.19 To date, the UK has not had to release emergency stocks of crude oil or petroleum products for such circumstances, and to date oil distribution has remained resilient to events which have impacted significantly on domestic supply and distribution of petrol products (such as the Buncefield Oil Terminal Fire in 2005). DECC monitors the market and downstream oil infrastructure to assess potential risks to supply in the domestic and international markets. If there were an event with severe impacts to the supply of product in the UK then DECC would inform the European Commission and develop a plan for domestic release to bridge the gap in supply.

[6] http://www.iea.org/topics/oil/oilstocks/

Case for Change

Guiding Principles for Stockholding policy in the UK

2. DECC periodically reviews stockholding policy in the United Kingdom, and did so during the transposition of the latest European Directive into the Oil Stocking Order 2012. In parallel DECC has consulted with other Member States on the approaches that they have taken to managing their obligations to hold emergency stocks.

2.1 Unlike most other EU Member States, the UK has enjoyed a period of self sufficiency in oil over the last few decades, due to the discovery of reserves in the North Sea. Most other Member States who are not self sufficient in oil take a more centralised approach to their stockholding policy through either Government or industry led bodies. Some of these bodies purchased strategic reserves of oil from the outset, or have made use of strategic reserves built up during the Cold War.

2.2 In continuing to comply with our international commitments to hold emergency stocks, to ensure that the UK stands ready to participate in any international draw-down of stocks, and to manage any domestic draw-down of stocks should this be required, we have set the following guiding principles for our domestic stockholding policy:

- **The UK should continue to hold emergency stocks of oil and petroleum products to mitigate detrimental impacts on the UK, EU and IEA members** from global oil supply disruptions. The costs of holding emergency stocks in the UK will continue to be borne by companies producing, refining or supplying oil into the domestic market, and therefore will continue to be passed through to consumers in the price they pay for final products.

- **In order to ensure domestic resilience to supply disruptions, the UK would benefit from moving towards holding a greater proportion of its emergency stocks in storage sites in the United Kingdom**. The UK holds nearly 30% of its stock abroad; this is more than double the EU average, and far more than most EU Member States and restricts the amount directly available to handle domestic supply disruptions, or the impact of international supply disruptions on the UK market. Increased physical storage for products in the UK, particularly of those products most in demand would be of benefit in developing domestic resilience and would offer greater choice to obligated companies for holding stocks as well as reducing the UK's reliance on the international ticket market, particularly for middle distillate products such as diesel and aviation fuel. There may be a case for considering holding stocks above the international obligations that could be released to market in the event of regionalised supply disruptions (that do not represent national crises). The Government intends to keep this under review, in the first instance through seeking evidence on the costs and benefits of this through Part 2 of this consultation.

- **The composition of emergency stocks held in the United Kingdom should, as far as is reasonably practical, reflect the domestic consumption of these products in order to ensure that the UK is able to respond to global or domestic supply disruptions quickly and effectively and with products that are in demand**. Currently companies are required to hold 1/3 of the obligation in the products most in demand domestically (petrol, diesel and aviation fuel). The Government intends to keep under review whether the UK should store more than a third of the obligation in finished product particularly as the UK's dependency on imports of diesel and jet fuel continues to increase.

- **As far as possible without posing undue burdens on consumers, products should be held in a number of different locations throughout the UK, to provide further resilience**. DECC is satisfied that currently, in practice, this is the case and intends to keep this under review, in the first instance through seeking evidence on the costs and benefits of this through Part 2 of this consultation.

- **As far as reasonably practical, recognising the importance of providing resilience the UK's approach to stockholding should be efficient and represent value for money in meeting the overall objective of holding emergency stocks to respond to supply disruptions.**

2.3 As part of keeping these principles under review, we are also using this consultation to call for evidence on the UK's approach to stockholding and stock draw more generally, and to test if there are further measures that might support our domestic resilience, considering approaches taken in other EU and IEA Member States. A Call for Evidence on these and other potential resilience measures is set out in Part Two of this Consultation.

2.4 DECC is of the view that there is a case for considering developing alternative means for managing the Compulsory Stockholding Obligation in the UK. There are three main reasons for considering a change in approach.

- **The obligation is increasing and it is increasingly difficult to meet this through physical storage** as domestic production of oil declines and we become increasing reliant on imports to meet domestic demand. The storage capacity available in the UK is limited.

- **Lack of incentives to invest in physical storage**, meaning that we are reliant on the international ticket market which is volatile and may not be in our best interests domestically. This varies by product, and we have least storage capacity for products most in demand such as diesel and aviation fuel.

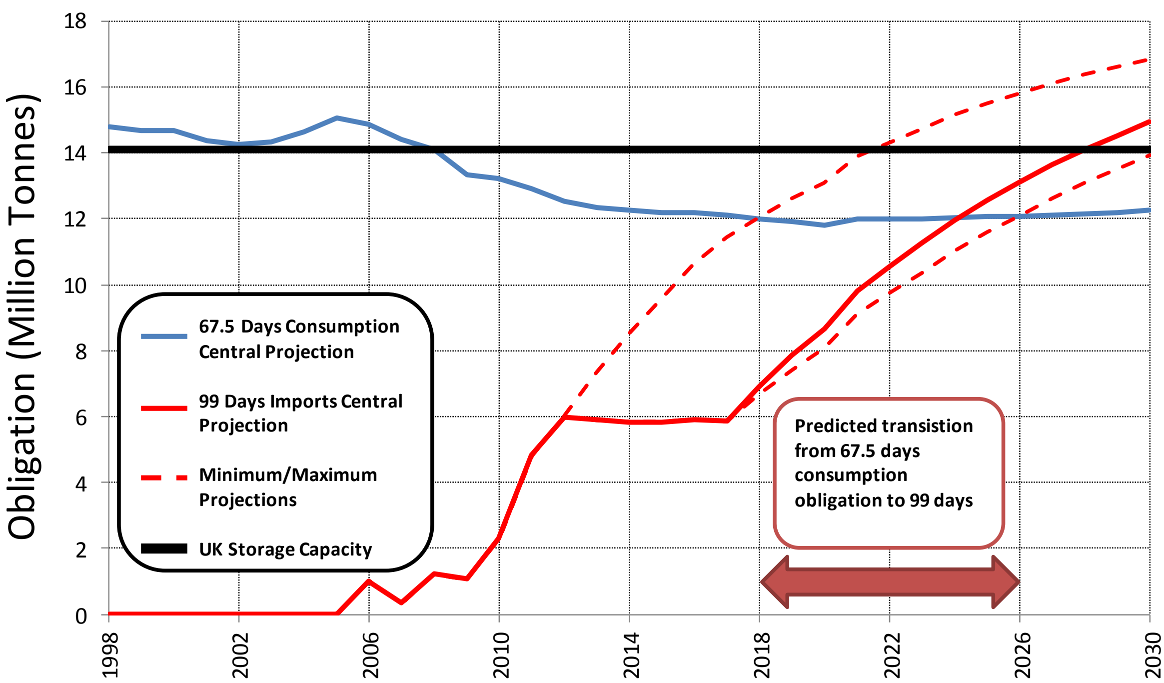
- **Potential to achieve economies of scale**: currently companies do not work together to manage the obligation due to both legislative barriers prohibiting sub-delegation, and to avoid competition concerns. A central body might achieve better access to finance, and also be able to develop larger storage sites so benefitting from economies of scale.

The obligation is increasing:

2.5 The UK is required to hold the higher of 90 days of average net daily imports or 61 days of average daily inland consumption in order to mitigate the effects of a supply disruption. Under the terms of the EU Directive, 10 per cent of stocks are deemed to be inaccessible (e.g. through being held in tank bottoms). Accordingly, Member States are in effect required to hold just over 67 days of net daily consumption, or 99 days of net imports.. For the UK, as an oil producing country, this means that we have to hold 67.5 days of average daily inland consumption which currently represents a higher volume – this currently is around 12.5 million tonnes of crude oil equivalent. Further, one third of those products which make up the majority of oil consumption in the UK (motor gasoline, kerosene type jet fuel and gas/ diesel oil) must be held as finished product. This is equal to ~1 million tonnes of motor gasoline, 0.9 million tonnes of kerosene type jet fuel and 1.9 million tonnes of gas/diesel oil.

2.6 As UK crude oil production declines, and this demand is increasingly met by imports, the volume of oil representing 99 days of average net daily imports (i.e. how much oil is imported over a 99 day period) will increase until this is greater than the equivalent volume for 61 days of consumption. DECC has produced forecasts to assess how the obligation is likely to change between now and 2030.

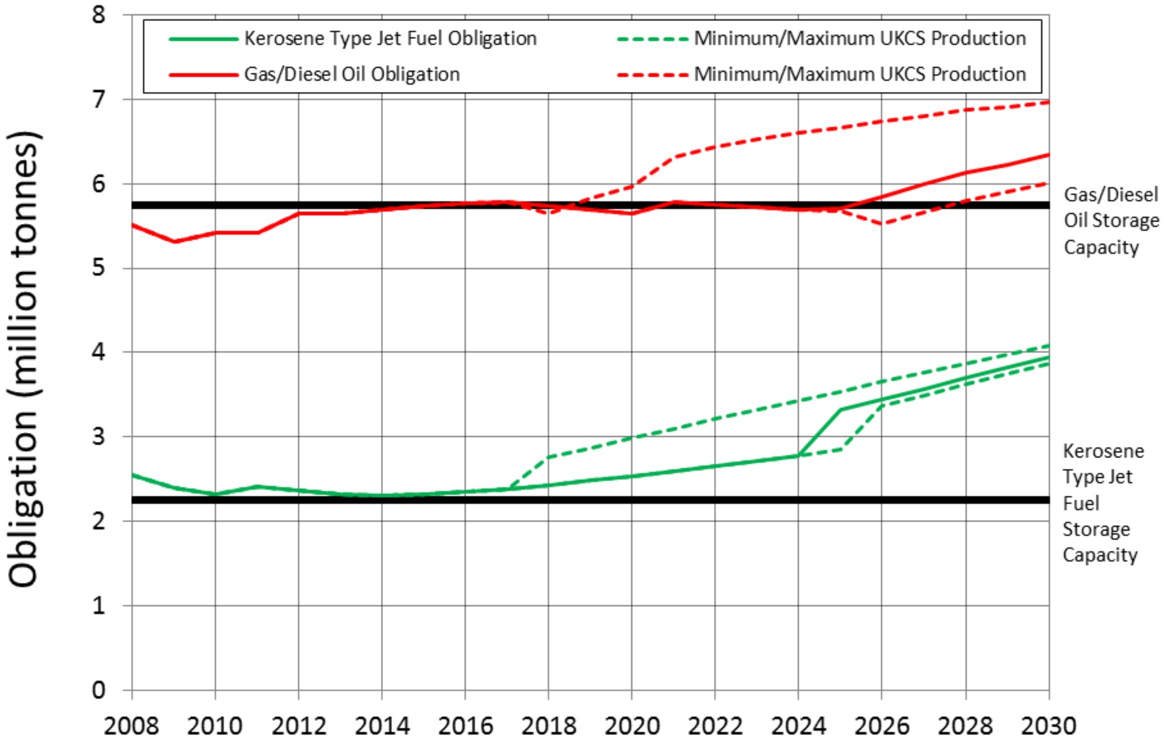
UK petroleum products as primary oil



2.7 Under the central projection, we currently forecast that the obligation based on 90 days of imports will start to overtake the 67.5 days of consumption obligation from 2024, and therefore if the current system continues this will result in an increase in the obligation of individual companies. This date is highly dependent on the production of the UK continental shelf, and should this continue to decline at the current rate this could be as early as 2018.

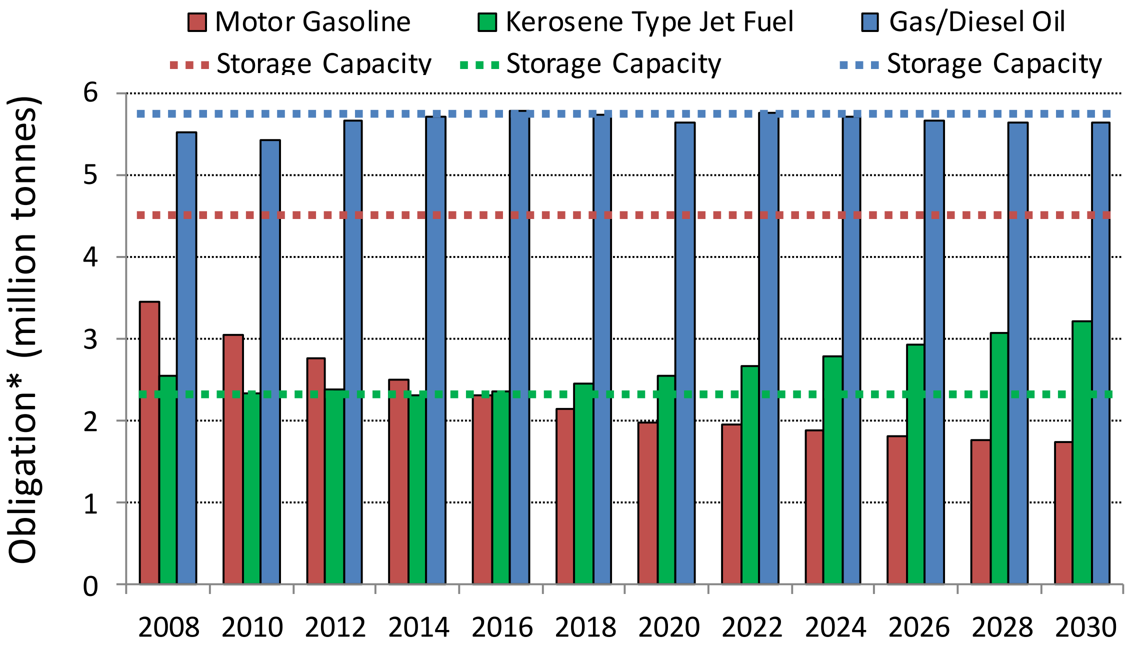
2.8 DECC has estimated total storage capacity available in the UK at approximately 14Mt – this takes into account a previous survey of capacity of obligated refiners, and storage available elsewhere in the market. Not all of this storage will be used to hold stocks towards the compulsory stocking obligation, and a certain level of storage will be required for day to day management of business. Whilst the UK is relatively well placed for storing light distillate such as petrol and heavy distillates such as fuel oil, there is less storage capacity available for diesel or aviation fuel ("middle distillates"). This is because refineries in the UK were originally designed and configured primarily to refine petrol and fuel oil. The UK, along with other countries in North West Europe has increasingly moved towards the dieselisation of road vehicles and also seen significant growth in the aviation market, with associated increased dependency on jet fuels.

2.9 Both diesel and jet fuel are "middle distillate" products, and are produced in lesser quantities in the UK. Therefore in the longer term, there is an EU wide predicted increase in reliance on the international ticket market, and the likelihood is that the supply of tickets will reduce in Europe as the deficit of middle distillate products increases. This will lead to an increase in the cost on industry (if current ticket:stock ratios remain the same/ increase) and associated risks of non compliance potentially reducing UK ability to mitigate the effect of a severe international or domestic supply disruption.



2.10 The above graph demonstrates that the obligation for kerosene type jet fuel (aviation fuel) will surpass the total UK storage capacity for this product from 2016 onwards under all scenarios, and also demonstrates the capacity for gas/diesel oil storage compared with the projected obligation out to 2030.

2.11 Some of the figures in the consultation document have been updated since the modelling for the Impact Assessment. This does not have material impact on the policy rationale, and the final Impact Assessment (post consultation) will include the latest modelling available.



2.12 As these charts demonstrate, if the increase in the obligation were to be met through holding these additional stocks in storage facilities in the UK, our forecasts suggest that even if all the UK storage capacity was used towards meeting the obligation, further additional storage needed could be in the region of 1million tonnes by 2025.

2.13 DECC is minded to encourage companies to meet the obligation through holding increased physical stocks in the United Kingdom over time as this offers the greatest domestic resilience to supply disruptions (either directly, or through UK ticket arrangements with non obligated companies).

2.14 The uncertainty over the increase in the obligation, and the associated cost of complying with this has raised questions from industry over the effectiveness of the current policy approach. In particular, they are concerned that the current framework may not incentivise the necessary investment in storage capacity.

Lack of incentives to invest in storage

2.15 As set out above, significant investment will be required in new storage facilities in the UK in order to meet the increase in the obligation through physical stock holdings. The current system may not be the best means to encourage investment in storage, as storage build for individual companies is expensive and carries risk. As this investment is to meet a statutory obligation and does not represent a competitive advantage most companies are reluctant to allocate large amounts of liquid capital for investment in long term storage facilities to meet the obligation when higher returns are available elsewhere.

2.16 Whilst the costs of meeting the obligation are only expected to increase, the commercial value will remain flat or depreciate. The consequence of this is that companies are not investing in storage facilities.

2.17 DECC has heard that companies find the costs of meeting the obligation to be non-transparent and that these tend to be woven into operating costs, meaning companies have no incentive to invest in response to the increasing obligation. As a result, companies may prefer to meet any obligation they cannot directly service through existing storage by relying on the ticket market.

2.18 In the short term, companies have an incentive to cover incremental obligations through tickets (either domestically or bilaterally) to keep short term costs down. This may not be in the interests of the UK in terms of ensuring our domestic resilience to international or domestic supply disruptions.

2.19 The investment case is further affected by the nature of the Downstream Oil Sector in the UK, which has seen significant rationalisation and consolidation over the last few decades leading to a number of asset closures including storage facilities. Such investment is also unlikely at a time when much of the sector faces low margins and increased competition from Asia and the Middle East and overcapacity in the sector.

2.20 Furthermore, demand for fuel in the OECD is also declining and the current product mix of UK refineries is out of balance with the UK market and the risk of industry consolidation remains. These market conditions mean that it is unlikely that market participants will make investment in storage to meet the obligation when some favourable returns may be achievable elsewhere, or if there is a possibility of market exit.

2.21 As UK production continues to decline and our reliance on imports grows, DECC is of the view that it will be increasingly important to ensure that there are sufficient emergency stocks stored domestically in order to provide resilience to supply disruptions. Therefore DECC is keen to ensure that measures are put in place to ensure that investment to develop additional UK storage capacity takes place.

Potential to achieve economies of scale

2.22 Currently companies are restricted from working together to invest jointly in storage due to concerns over compliance with competition law, and also the anticipation that Government may intervene by setting up a centralised solution such as a stockholding agency / facilitating industry working together to establish a centralised solution. The current system may therefore create inertia and a coordination problem preventing companies from jointly investing in storage. This prevents the development of large storage facilities that could be used to hold significant amounts of the obligation, which could be developed at lower cost than smaller storage sites.

2.23 In addition, as obligated companies must be compliant at all times (not just for month end reporting) they tend to hold a contingency buffer of stocks above what is required. This potentially puts UK companies at a competitive disadvantage, as they employ greater working capital and face higher sunk costs relative to companies in other EU member states which have an established agency and face a fixed annual cost.

2.24 The UK is one of the few countries to operate a compulsory stock holding system where the responsibility of meeting and organising the compulsory stockholding obligation is placed fully on oil market participants. The nearest equivalent system is in Italy where the responsibility for meeting obligations is placed solely on the market operators, but the Government is involved in determining the allocation of the actual physical location of stocks between different categories of operator7.

2.25 A more centralised approach such as an agency model might provide better access to finance for the necessary investment and on more favourable terms than smaller individual companies. This is because of the guaranteed income stream which an agency would have from member companies, and the potential to fund investment in storage through loans from member companies.

Consultation Question	
1.	**Do you agree with the assessment of the case for changing approach in the UK? Are there other factors that should be taken into consideration?**

[7] Differentiated Obligatory Oil Stockholding Requirements in the UK EMC Energy Market Consultants report for DTI, June 2006

Potential Future Approaches

2.26 A range of approaches are taken by other IEA and EU member countries. For example, the United States has a Government Strategic Reserve, whereby the Government has purchased emergency stocks from the proceeds of general taxation (in the region of $22bn) and these are managed by a State Department. In other countries, such as Ireland and Germany, there is a central agency which manages the overall obligation, funding this through companies producing and supplying oil products in country.

2.27 The EU Directive enables Member States to set up a Central Stocking Entity. This is a body or service upon which powers may be conferred to act to acquire, maintain or sell stocks, including emergency stocks and specific stocks. A Central Stocking Entity must be a not for profit body, acting in the general interest, and not as an economic operator. The Directive notes that the availability of oil stocks and the safe guarding of energy supply are essential elements of public security for Member States and for the Community. The existence of Central Stockholding Entities in the Community brings these goals closer.

2.28 The Commission has indicated that a Member State could make use of an industry related entity as the CSE, provided a clear act of the Member State establishes or designates such an entity as its CSE and the entity satisfies all the requirements set in the Directive[8], including the prohibition of profit objectives, the obligation for the body or service to act in the general interest and not to be an economic operator, and the obligation for the CSE to have as its main purpose to acquire, maintain, and sell stocks for the purpose of the Directive or for the purpose of complying with international agreements concerning the maintenance of oil stocks. The Directive also provides that such a body may be empowered to acquire or sell specific stocks[9].

2.29 DECC is of the view that a Central Stocking Entity may be a better approach to meeting our policy framework for oil stockholding in the UK. This is because this approach would provide greater incentives to invest in increased storage facilities in the UK, and would reduce the burden on individual companies of managing the obligation through ensuring cover throughout the month. We are using this consultation to set out the potential models for delivering a Central Stocking Entity in the UK, and to seek views on the costs and benefits of these approaches.

2.30 Subject to the responses to this consultation, if DECC was minded to work with industry to create a Central Stocking Entity in the UK, we would intend to designate an industry body as the UK's Central Stocking Entity through primary or secondary legislation. The nature of the legislation would depend on the final model of the body, and whether or not it required compulsory membership. A Central Stocking Entity would be

[8] Frequently Asked Questions and Answers related to Council Directive 2009/119/EC document prepared by the Commission for Member States, updated October 2012.

[9] A specific stock refers to those included in the EU Council Directive 2009/119/EC Article 9.

able to delegate tasks relating to the management of emergency stocks to other economic operators meaning that companies within the UK could hold stocks on behalf of the CSE through entering into contractual arrangements with the body. It would be required to publish information on the stock volumes that it maintained and to supply this to DECC for forward transmission to the European Commission and IEA. Such a task, once delegated, cannot be sub delegated by the company.

2.31 Any future Central Stocking Entity in the UK would need to be compliant with the Oil Stocking Directive. Under the terms of the Directive, its roles and responsibilities would include the following:

- To publish conditions (at least 7 months in advance) subject to which it would provide services related to maintaining stocks for economic operators.
- To accept delegations of stock from economic operators under objective, transparent and non-discriminatory conditions
- To ensure that payments to the CSE do not exceed the full costs of services rendered and may not be required until stocks are constituted.
- To make the acceptance of a delegation conditional upon operators provision of a guarantee or other form of security.

In the longer term, once established:

- To publish on an on-going basis, full information broken down by product category on the stock volumes that it can undertake to maintain for operators

2.32 These conditions would not preclude a Central Stocking Entity developing a surplus of funds in order to invest in storage. DECC's initial view is that this would be consistent with the responsibility to acquire, maintain and sell stocks.

Consultation Question	
2.	**Should the UK move towards a more centralised means of managing the obligation, such as through a Central Stocking Entity? Please explain your reasons.**
3	**Are there sufficient incentives for member companies of a Central Stocking Entity to invest in storage capacity in the UK? Are these stronger than the existing investment climate for individual obligated companies or other companies within the UK market to invest?**

2.33 Industry have informally indicated to DECC that they think there could be merit from adopting a Central Stocking Entity in the UK because the costs are more transparent, e.g. the agencies publish their accounts on an ongoing basis, and are more consistent, usually constituting a fixed annual or quarterly fee to be paid by companies producing or supplying oil and oil products into the domestic market. This would enable companies to plan for these costs on a longer term basis, rather than managing the cost month by month, and would also enable industry to better explain the cost pass through to their customers. A Central Stocking Entity could also manage the impact of market exit by obligated companies.

2.34 It is also the case that for the obligation to be managed by a centralised body in the UK, this would have to be formally designated a “Central Stocking Entity”. Under the terms of the Directive, without this status, the body would be unable to benefit from the power in the Directive that allows “sub delegation”. This is because an oil stocking agency that was not designated as the UK’s Central Stocking Entity would not be able to “delegate” tasks, as it would be classed an “economic operator” under the terms of the Directive (Article 7(3)b). This means effectively that the body would be required to hold all the stocks towards the obligation, and would be unable to make use of stocks held by the current obligated companies or other companies with the capacity to store stocks in the United Kingdom. It would be able to take on part of companies’ obligations, but would not be able to manage these in any way other than through directly holding physical stocks. This is a barrier to setting up a voluntary model, as it would not be practicable for a single entity to take on the full obligation in the UK immediately. Industry has indicated to DECC that there would be significant financial barriers to an agency holding physical stocks from the outset, and therefore that for an agency to work, it would need to be designated a Central Stocking Entity from the outset.

2.35 There are a number of ways in which a Central Stocking Entity could be set up in the United Kingdom by Government and industry. Any future approach would need to be compliant with EU and domestic legislation, and also be consistent with the framework for UK stockholding policy set out earlier in this document.

2.36 DECC has been working with the Trade Associations; the UK Petroleum Industry Association and the Downstream Fuel Association to consider alternative approaches to the future management of the Compulsory Stocking Obligation. DECC has considered the model proposed by UKPIA and DFA and the following models have been informed by analysis undertaken by these bodies, by the Future Management of the Compulsory Stocking Obligation Project Board (attended by DECC, UKPIA and the DFA) and by the Downstream Oil Industry Forum, chaired by the Minister for Energy and Climate change.

2.37 There are two main models that Government has considered that might be implemented in adopting a Central Stocking Entity:

- Industry owned industry operated stockholding agency, with compulsory membership from obligated companies
- Industry owned industry operated stockholding agency with voluntary membership

2.38 At this stage we have ruled out considering establishing a Government run Central Stocking Entity. This option has been modelled in the Impact Assessment. This is because it is more appropriate for the industry to develop and manage a stock holding agency as this is where the expertise for purchasing and managing stock lies.

Industry owned industry operated agency with compulsory membership

2.39 An industry owned industry operated stockholding agency could be set up as a private, Not for Profit Company incorporated under the Companies Act 2006 and limited by guarantee. Under this approach, companies who are subject to the Compulsory Stocking Obligation in the UK would be required in legislation to delegate a minimum % of their obligation to the stockholding agency. Over time, and subject to agreement from member companies, this minimum % could be increased. This agency would be self-financed, operating at arm's-length from the Government.

2.40 In order for this agency to have compulsory membership, DECC would need to take primary legislation to provide the body with powers to compel all obligated companies to join the agency, and to require them to pay the fees for managing the obligation on their behalf to the agency. Subject to this consultation, if DECC were minded to take this approach this legislation would be brought forward subject to parliamentary time being available. The current energy bill would not be a suitable vehicle for implementing this legislation.

2.41 For a Central Stocking Entity to be most effective, DECC is of the view that compulsory membership of all obligated companies is required. This would give the Agency certainty to plan for its operation and to be able to clearly communicate costs to members. On the basis of engagement to date with industry, it is considered that there is no driving incentive for voluntary membership of an agency, as in the short term it is likely that it will usually be more profitable for companies to find cheaper ways to obtain cover for their share of the obligation. Unless required to do so, it is unlikely that all companies would value the long term benefit of setting up an agency from the outset over the short term benefit of lower cost. This could prohibit success of a voluntary model as there needs to be a "level playing field" from the outset. With all obligated companies being members of the agency from the outset, it would also ensure that the costs of operation and set up were shared evenly across obligated companies, and mitigate the risk that late joiners benefit from the investment of early starters.

2.42 A fixed income stream, derived from compulsory membership, would also mean that the agency had better access to credit, and possibly at better rates than those available to individual companies. All obligated companies would become members of the company. This would provide them with voting rights over the direction of the agency.

2.43 An Impact Assessment has been published alongside this consultation. This sets out that the potential benefit to business (p.a.) from a centralised private stockholding agency model of is estimated at £1.18m p.a. The cost savings are from reduced storage costs through companies no longer holding a "contingency buffer" above their obligation. Currently, on average companies tend to hold stocks above their obligation in order to ensure continued compliance – as they need to be compliant throughout the month, not at a fixed point monthly. As, in the longer term, only one body would be responsible for holding stock, the agency would hold a smaller buffer than that managed by all obligated companies in aggregate. The value of this reduction in contingency buffer (held by companies) is at £15.9 million (in present value terms).

2.44 By storing less oil or refined product, the companies would be able to benefit from the opportunity cost by using that product / oil that they would have used as buffer for other commercial use. This is valued at £26.8 million (in present value terms). The lower cost of capital that the agency is thought likely to be able to achieve (under the compulsory membership model) is estimated to provide savings of £1.2million.

2.45 The agency would have detailed Articles of Association, rules and by-laws setting out its governance structures. If this is the preferred approach following consultation then DECC will work with UKPIA, DFA and obligated parties on a roadmap to developing the agency, with further detail on this elements of the Agency for further discussion with stakeholders.] This would also set out the timetable for bringing forward the Agency and the necessary legislation.

2.46 DECC is of the initial view that the minimum delegation should be fixed at 25% in the first instance. This is to ensure that the agency is larger relative to obligated companies, holds sufficient stocks to respond to an emergency and be able to maximise economies of scale when purchasing cover. This will be considered further following consultation, and set out in the roadmap.

Consultation Question	
4.	Would an industry owned industry operated stockholding agency be a more efficient means of managing the obligation in the United Kingdom? Are there other factors that need to be taken into account?
5.	What would the costs and benefits be of an industry owned industry operated stockholding agency?
6.	Do you agree with the assumptions set out in the Impact Assessment, including the assessment of a benefit from reduced “contingency buffer” of stock held by individual companies?

Indicative timetable for creation of industry owned industry operated agency with compulsory membership:

Summer 2013	Joint Industry Government Roadmap, setting out further detail on proposals for the Articles of Association and funding arrangements of the agency. This would set out the proposed timetable and process for establishing the agency. Any timetable would be subject to Parliamentary timetable being available.
Agency set up. Oil Stockholding Bill brought forward in UK as parliamentary time allows.	
Phase one (years 0-5)	Once the agency is set up and the Oil Stocking Act given Royal Assent it would enter phase-one of operations. During this phase: 1 Agency to publish proposed fees and terms for delegation contracts, including conditions subject to which it is willing to provide services relating to maintaining the stocks for economic operators, at least 7 months in advance in accordance with Article 7(4)b) 2 DECC would issue directions to obligated companies. Under the terms of the Oil Stocking Act they would be required to delegate a % of this obligation to the agency. 3 Companies enter into delegation contracts with the agency setting out the terms on which this % is being delegated. These would set out the fees for the companies to pay for the delegation. 4 During this phase, the agency would meet its share of the obligation through contractual storage arrangements domestically and with companies or CSEs in other Member States.
Phase two (year 5-10)	At this point, subject to agreement from member companies that the agency is functioning as expected, the % delegated by individual companies to increase. Once this approach had been determined, the agency to submit plans to DECC for developing capacity to take physical ownership of stocks and development of its own storage facilities.
Phase three	Review of the agency performance, and decision to be taken by Government over whether the agency should start to be directly obligated for the full obligation in the UK.

Industry owned industry operated agency with voluntary membership

2.47 Whilst DECC is of the view that compulsory membership would be required to ensure stability and certainty for future planning of the agency, we would also welcome views on the viability of a voluntary model, and if this could work in the UK. DECC has heard from some members of industry that this model is not thought to be as viable as it risks companies not joining the agency from the outset, and late joiners benefitting from early starters.

2.48 On the basis of engagement to date with industry, it is considered that there is no driving incentive for voluntary membership of an agency, as in the short term it is likely that it will usually be more profitable for companies to find cheaper ways to obtain cover for their share of the obligation. It is unlikely that without being required to do so, all companies would see the long term benefit of setting up an agency and being a member from the outset, which could prohibit success of a voluntary model as there needs to be a "level playing field" from the outset.

2.49 A voluntary agency could be implemented with the same phases as the compulsory model, but all obligated companies would be given the choice of joining the Stockholding Agency and delegating the minimum percentage. The potential key benefit to a voluntary agency is that this could be implemented more quickly and through a less complex legislative route. If this were the preferred approach, DECC would designate the Stockholding Agency through secondary legislation under the European Communities Act 1972 without the need for new primary legislation. This would give the body Central Stocking Entity status under the terms of The Directive.

2.50 Companies who voluntarily opted to delegate a minimum % to the Agency would agree terms with the agency and determine these through the delegation contracts. As under the compulsory model, the agency would be required to publish details of proposed terms including conditions subject to which it is willing to provide services relating to maintaining the stocks for economic operators, at least 7 months in advance in accordance with Article 7(4)b)

Consultation Question	
7.	**Could a voluntary agency be a more efficient means of managing the UK's obligation?**
8..	**What incentives could be provided to encourage companies to join the Agency?**

Government Strategic Reserve

2.51 DECC has considered the case for creating a Government Strategic Reserve in the UK to manage the increases in the obligation and set out the costs and benefits of this model in the Impact Assessment.

2.52 Under this model, companies would continue to be obligated to meet the current obligation (of approximately 12.5 Mt of crude oil equivalent), but Government would create a public body to manage the increase in the overall stockholding obligation by purchasing physical stocks to meet this. The set up costs and ongoing costs would be funded by a levy payable by each oil company and consumer oil products. In order to create this levy, Government would need to bring forward primary legislation. Whilst levies are one model, another approach to provide Government backing to a centralised model would be through putting the stocking entity on the Government balance sheet.

2.53 DECC is of the view that this is not a viable option in the UK, and is not consistent with the current Guiding Principles for UK Stockholding Policy set out earlier in this document. We are not seeking views directly on this option, but more detail on the costs and benefits can be found in the Impact Assessment.

COST BENEFIT ANALYSIS AND ASSUMPTIONS

An Impact Assessment has been published alongside this consultation. We are seeking your views in this consultation on the costs and benefits set out in this document. Please provide evidence to support your answer, where available.

Current cost of obligation

The total cost of servicing the obligation for 2012 has been estimated at £186m. This includes the operating cost of storage and buying tickets (based on the ticket:stock ratio seen over the last 5 years), but not building new storage or buying stock.

For the purposes of the impact assessment the obligation has been forecast using the 3 respective categories under the previous Oil Stocking Directive. To assess the cost of the obligation we have assumed the total obligation is met through final product (diesel, kerosene, petrol in quantities equivalent to approximately 12 MT of crude oil equivalent. This has the added benefit of simplifying the calculations and ensuring transparency whilst not materially changing the estimates.

We have estimated the value of the physical product held by companies towards the obligation at £7.7bn. This is calculated as proportion of CSO met with physical stock X the current price of product.

These estimates will be updated as a result of evidence received during the consultation

Cost to 2042

If the obligation did not increase, the cost of <u>servicing</u> this to 2042 would be £5.6bn.

DECC analysis suggests that the forecast increase in CSO could lead to an estimated additional cost of £3.1billion by 2042, or £1.4billion in present value (PV) terms. This cost consists of the building and operating costs for storing physical product and the cost of purchasing tickets.

Benefits of policy option

The net benefit of the policy option has been calculated at £24.5m PV. This consists of

A lower ‘contingency buffer’ under the agency option resulting in a saving of £15.9m PV relative to the base case.

A reduction in the cost of capital of 0.5ppts, compared to that of a private sector company, results in savings of £1.2m in PV terms.

In addition, under option 3 there is a benefit from the opportunity cost of storing the oil under the base case. In general the opportunity cost of storing product is the foregone interest on the value of the product plus the costs of storing it. At an aggregate level a lower ‘contingency buffer’ is equivalent to storing less product and thus there is a benefit equal to the lower opportunity cost of storing less. This has been assessed to be the foregone interest and is valued at £26.8m in PV terms.

Initial costs of setting up the agency, valued at £1m, as well as on-going costs of the agency, including staffing costs and associated overheads, estimated at £18.4m in PV terms.

In addition, an agency may be able to reduce the risk of non-compliance and so increase resilience when faced with global supply disruptions, as well as offer increased resilience in the event of a closure of a refinery as the agency manages the obligation centrally and would adjust the fee to compensate rather than companies being forced to accommodate the change in their obligation themselves.

A more detailed discussion of the benefits and costs of the policy can be found in the accompanying impact assessment.

Assumptions for calculating current cost/benefits of policy

An appraisal period of 30years has been used to best represent the time horizon of impacts of the policy and capture the long term issue of the problem under consideration.

To establish the current cost of meeting the CSO, DECC forecasts of future CSO levels are used, with a 5% uplift for assumed ‘contingency buffer’, and taking into consideration current surplus stocks that could be used to meet future increases in the obligation. For the split between proportion of the CSO met with tickets or physical stock, we use the physical/ticket average ratio over the last 5 years and keep this constant going forwards. All new physical stock is met through the building of new storage, with an associated building cost of £242/tonne and operating costs of £31/tonne/year. Incremental tickets are assumed to be held bilaterally i.e. not held in the UK.

Product prices are estimated using DECC oil price projections to 2030, and then flat-lined thereafter. Ticket price and availability are estimated by applying scenario analysis on ticket prices assuming three scenarios. The current price case is based on Q4 2011 companies and brokers information provided confidentially to DECC.

Agency costs have been sourced from a Deloitte report “Assessing the current system for meeting the UK’s stocking obligations” that assumed that one-off costs to reflect the transition to an agency would be £1m. In addition, recurring costs have been assumed to be £1m each year and cover recurring staffing costs and associated overheads.

An agency would have better access to financing options than individual companies as it can gain from risk pooling and therefore gain access to cheaper credit and we have thus assumed the agency would benefit from 0.5ppt cheaper credit. The respective costs of debt we have used are 8.5% for individual companies and 8% for the agency. We assume 100% debt financing.

At present individual companies operate an additional buffer stock over and above the obligation to mitigate against risk of non-compliance and short-term variability in demand and supply. In establishing a base case, we have estimated individual companies maintain a contingency buffer of 5%, using Deloitte estimates. Under the policy option this margin is assumed to decline to 4% because on a national scale demand is more stable than individual company product sales, the CSO is likely to be more predictable and the agency would therefore have scope to reduce this contingency buffer over and above the obligation.
To assess the opportunity cost we have assumed a 6.5% real rate of return, based on a sample of large oil companies the average cost of equity sourced from Bloomberg was 10.7% (real) which we have adjusted down to allow for large company sample bias.

Do you agree with the assumptions set out in the Impact Assessment, including the assessment of a potential benefit from reduced “contingency buffer” held by individual companies?

Summary of Consultation Questions: Part One

Consultation Question	
1.	**Do you agree with the assessment of the case for changing approach in the UK? Are there other factors that should be taken into consideration?**
2.	**Should the UK move towards a more centralised means of managing the obligation, such as through a Central Stocking Entity? Please explain your reasons.**
3	**Are there sufficient incentives for member companies of a Central Stocking Entity to invest in storage capacity in the UK? Are these stronger than the existing investment climate for individual obligated companies or other companies within the UK market to invest?**
4.	**Would an industry owned industry operated stockholding agency be a more efficient means of managing the obligation in the United Kingdom? Are there other factors that need to be taken into account?**
5.	**What would the costs and benefits be of an industry owned industry operated stockholding agency? Do you agree with the costs and benefits set out in the Impact Assessment for this option? Please provide detailed evidence as available.**
6.	**Do you agree with the assumptions set out in the Impact Assessment, including the assessment of a potential benefit from reduced "contingency buffer" held by individual companies?**
7.	**Could a voluntary agency be a more efficient means of managing the UK's obligation?**
8.	**What incentives could be provided to encourage companies to join the Agency?**

Part Two: Call for Evidence on Resilience Options

DECC is interested in hearing views on whether there are more general changes to our stockholding policy that can be made to improve our domestic resilience to oil supply disruptions. In considering potential changes, DECC has considered the approach taken in other EU and IEA Member States, and information on a range of approaches is provided at Annex A.

The measures below could be applied to our current policy ("business as usual") or to any of the potential models for creating a Central Stocking Entity in the UK. We are interested in stakeholder's views on the timing for implementing these changes, and whether these could be better managed through the current model or through a Central Stocking Entity model.

DECC would be grateful for information on the costs and benefits of these approaches. In providing a response to these questions, it would be helpful for respondents to provide a view on the transitional arrangements that would be required if the UK were to make a change to this approach, and what timescale might be appropriate.

Form in which stocks are held:

The objective of the UK policy on Compulsory Stocking to date has been to ensure that stocks are available for release to the international market As set out in the consultation document, currently there is a high degree of flexibility over the way in which companies can meet the obligation, and particularly over where stocks are held.

This means that, in practise around 30% of the total stocks held to meet the UK's obligation are typically held abroad.

Under the terms of the EU legislation; the UK is required to hold 1/3 of the obligation in the form of the finished products most in demand in the UK (diesel, gasoline and aviation kerosene). Currently these stocks may also be held in other Member States through international ticket arrangements.

Consultation Question	
1.	Does holding 1/3 of the obligation in finished product provide sufficient resilience to support domestic resilience in the event of a supply disruption? Do you think that a greater proportion of the obligation should be met through finished product, or are there benefits to holding most of the obligation in unrefined products? Would holding these finished products in the UK provide more resilience to supply disruptions? Please provide evidence to support your response.
2.	Is there a case for limiting the overall level of stocks that may be held in other EU Member States? What are the costs and benefits of storing stocks domestically and abroad?

3.	Should the UK consider revising the approach taken to implement the EU Oil Stocking Directive, and change the product range that companies are obligated to cover?

Where stocks are held:

In some other Member States (including Germany and France), in order to mitigate the local impact of global or domestic supply disruptions a proportion of stocks (for example, 15 days worth of consumption in key products) are held on a regional basis.

In the event of a supply disruption either domestically or one with impacts domestically, it could be beneficial for stocks to be held at points that are integrated into the supply chain. Currently in practise most stocks tend to be held at UK refineries or terminals with good links into the supply chain.

Consultation Question	
4.	What are the costs and benefits of Government providing mandatory guidance on the location of stocks held to comply with the CSO, to ensure these are well dispersed in the UK reflecting domestic supply envelopes or regions?

How stocks are released:

In some other Member States with Central Stocking Entities, if they are participating in a stock release then emergency stocks are first offered to member companies of the Stockholding Agency. This could provide greater certainty and transparency that stocks have been released into the market.

Consultation Question	
5.	If a Central Stocking Entity is established in the UK, should it be required to first offer stocks to member companies during a stock draw? What are the costs and benefits? Can you see any issues with this approach?

Who holds stocks:

As set out in the consultation, currently companies producing or supplying over 50 000 tonnes of oil/ products a year are subject to the obligation. As the obligation increases, there may be a case for revising this threshold to spread the burden more widely amongst industry. The UK is one of only two EU Member States with this threshold.

Consultation Question	
6.	Should DECC review the range of companies obligated, and considering obligating either a wider range of market participants, or companies producing and supplying smaller volumes of product?

As set out in the consultation, currently the differential between refiners and non refiners obligations is set at 9.5 days. Since this was last reviewed, the importers share of the market has increased, and particularly when considering products most in demand in the UK. DECC will commission an analytical study on the differential between importers and refiners, to consider whether this is still appropriate following the changes seen in the market over the last ten years. At this stage, we are seeking preliminary views on the approach that this study should take.

Consultation Question	
7.	Should the differential be increased / decreased / maintained? What are the costs and benefits of changing this? What should DECC consider in reviewing the differential?

What level of stocks are held?:

The current policy approach is to direct companies to hold the level of emergency stocks that the UK is obliged to hold to meet EU and IEA requirements for stocks to release to market following international oil supply disruptions.

There may be arguments for holding additional stocks to mitigate the impact of smaller scale disruptions.

Consultation Question	
8.	What would the costs and benefits be of requiring companies to hold stocks above our international obligation in the UK to mitigate the impact of smaller scale domestic disruptions?

ANNEX: INFORMATION ON APPROACHES TAKEN IN OTHER EU AND IEA MEMBER STATES

Austria

Import Dependency 91% | **Stockholding Agency** ELG, formed 1976 (Erdöl-Lagergesellschaft - Government backed Petrol Storage Company) | **Obligation** 27.5% of previous year imports | **Membership** Non-compulsory | **International Tickets** Allowed

Austria meets its stockholding obligation by placing stockholding requirements on industry. Companies may fulfil their stockpiling obligations in one of three ways:

- The company itself may build and manage stocks.
- Two or more companies may enter a common stockholding agreement.
- Companies may choose to transfer the stockholding obligation to a licensed stockholder with federal guarantee (most likely the ELG)

Most obligatory stocks are held by the non-profit stockholding company ELG which is an official licensed stockholding entity privately owned by OMV (largest listed manufacturing company state-owned until 1989) and three international companies. The ELG holds more than 98% of the Austrian compulsory stocks and is financed by annual storage fees charged to companies.

The Stockholding and Importing Law guarantees the availability of emergency reserves covering 90 days of net imports which covers emergency stocks equivalent to 27.5% of the previous year's imports. All importers (also distributors and consumers if applicable) of crude oil and/or oil products (including biofuels) are subject to stockholding requirements.

Denmark

Import Dependency N/A (exporter) | **Stockholding Agency** FDO formed 1964 (Foreningen Danske Olieberedskablagre - Government association Danish Oil Stockpile) | **Obligation** 67.5 days consumption | **Membership** Non-compulsory | **International Tickets** Allowed - limited

As Denmark is a net exporter, it is not currently required to hold emergency stocks under the IEA agreement. However, as an EU Member State, it is required to hold stocks corresponding to 67.5 days of oil consumption. The private sector covers the entire stockholding obligation through a non-governmental industry owned industry operated stockholding association established in 1964. The FDO is financed by oil companies and operates the stockholding on their behalf; it currently holds about 70% of the Danish compulsory stocks, mostly as finished products. Individual companies hold the remaining 30% in their commercial tanks.

The compulsory stockholding regulations stipulate that any company that produces or imports more than 1 Kt/yr must hold compulsory stocks corresponding to 22.2% of their annual domestic sales. Denmark law does not mandate specific regional stockholding within Denmark but limits bilateral tickets to just 10% of obligations.

Germany

Import Dependency 93.9% | **Stockholding Agency** EBV formed 1978 (Erdölbevorrtungsverband - Government Strategic Petroleum Reserve) | **Obligation** 90 days of imports | **Membership** Compulsory | **International Tickets** Allowed - limited

The *Oil Stockholding Law* requires the EBV to hold stocks equivalent to 90 days of net imports and of processed volumes of the main products (gasolines, middle distillates and fuel oils). These requirements comply with EU legislation and IEA commitments. The 90-days equivalent of the quantities of refinery output and net imports of major oil products is calculated on the average amounts of the three preceding calendar years, or during the last year, whichever figure is larger. Membership in the EBV agency is compulsory for refiners and importers. In principle Germany allows international stock ticket arrangements but for products only and restricted to a maximum of 10% of obligations.

The EBV holds 45% of stocks as crude oil and 55% as product and owns more than 90% of its stocks (10% delegated to the EBV by oil operators). Decisions on the split between crude and product are taken by the EBV Board. By law the EBV has to ensure stocks are distributed evenly throughout Germany on a regional basis.

Ireland

Import Dependency 100% | **Stockholding Agency** NORA formed 2007 (National Oil Reserves Agency - Government agency) | **Obligation** set by Ministers (usually just short of 90 days imports) | **International Tickets** Allowed

Since 1995, the responsibility for maintaining Ireland’s compulsory stock obligations has rested with NORA, which acts as an Non Departmental Public Body of the Department for Communications, Energy and Natural Resources. Ultimate decision making rests with the Minister for Communications, Energy and Natural Resources who is responsible for determining the obligation.

NORA holds compulsory strategic stocks, some of these in the form of tickets. Emergency stocks can be held in Ireland and/or in EU member countries where bilateral agreements exist although there has been a commitment to rebalance strategic oil reserve by maximising stocks held in Ireland.

NORA is required to hold strategic oil stocks at a level determined at least once per year by the Minister. Oil companies that import oil or deliver products into the domestic market for consumption and large oil consumers are expected to hold “prudent” levels of operating stocks. However, these operators are not required to hold any compulsory stocks. When formed there was a 0.476% levy on every petroleum litre sold which was increased to 2% in 2009.

NORA may hold its stocks in either crude oil or products, or as a combination of both.

United States of America

Import Dependency 65.1% | **Stockholding Agency** SPR formed 1975 (Strategic Petroleum Reserve - Government held stocks) | **Obligation** 90 (presently holding 80 days imports in the SPR alone) | **Membership** None – only Government | **International Tickets** Not used

The United States meets the stockholding requirements of the IEA through a combination of crude stocks held by the Strategic Petroleum Reserve (SPR) and stocks of both crude and product held by industry as part of their operating reserves.

The US emergency policy is to respond quickly to a major supply disruption with the release of crude oil from the SPR, relying on market forces to allocate the oil effectively.

The SPR can accommodate strategic reserves of up to 1 billion barrels. Under the *Energy Policy and Conservation Act*, the US government has exclusive authority over the drawdown and distribution of oil from the SPR. However, it has no powers over industry stocks.

At the current level of 696 million barrels, the SPR holds the equivalent of 80 days of import protection (based on 2012 EIA data of net petroleum imports of 8.72 MMB/D). Note: the maximum days of import protection ever held in the SPR was 118 days in 1985 although total capacity was held as recently as 2009.

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