Department of Energy & Climate Change

Future Management of the Compulsory Stocking Obligation in the UK

Government Response to Consultation

9 April 2014

URN [14D/105]

Any enquiries regarding this publication should be sent to us at
deccdownstreamoilteam@decc.gsi.gov.uk

Contents

1. Executive summary

Background

1.1. The UK holds emergency stocks of oil and refined products to release to the international market in the event of a supply disruption that requires a market intervention to bridge the gap in supply. The UK is party to two international oil stocking agreements, one from the International Energy Agency (IEA) and one from the European Union (EU). The EU Directive[1] requires that the higher of 61 days of daily inland consumption or 90 days of daily imports of oil be held (the IEA requires 90 days of imports are held). Currently the UK is obligated by the EU at 61 days of daily inland consumption, as we continue to produce oil from the North Sea. In line with the EU Directive, one third of this obligation must be held as petrol, diesel and aviation fuel, being the three most-consumed products in the UK. These requirements to hold oil stocks are known as the Compulsory Stocking Obligation (CSO)

1.2. Government directs companies supplying over 50,000 tonnes of oil products to the UK market in a calendar year to hold these stocks toward the obligation. Companies are unable to sub-delegate or co-ordinate their obligations as the EU Directive specifies that only companies specifically directed to hold stocks by a Member State or a Central Stocking Entity (CSE) designated by a Member government can hold stocks toward the obligation. Companies are able to hold these stocks either in their own facilities in the UK or in another EU Member State or alternatively reach an agreement (a 'ticket') for another company either in the UK or another EU Member State to hold stocks on their behalf.

1.3. To date this mechanism has allowed the UK to manage its oil stocks effectively. However, several issues were identified that may impact on the CSO and how it is managed in future. Firstly, the obligation itself may increase for the UK; reductions in North Sea reserves would mean that the UK would in time move to the EU's imports-based model, leading to higher obligations (DECC's central estimate presented in the consultation document was for this to happen in 2024). Secondly, storage capacity for oil products in the UK is limited, meaning the ability to hold these stocks in the UK would reduce and more stocks may need to be held overseas; government understand from industry that under the current system the incentives to invest in new storage capacity in the UK are limited. Thirdly, many in industry had indicated there may be benefits to a more centralised approach to the stocking obligation, citing the potential economies of scale this could bring.

1.4. Given these issues, DECC launched a consultation in April 2013 to seek views on changing the mechanism by which the CSO is managed in the UK. Also, in the consultation government set out five guiding principles for oil stocking policy in the UK to help contextualise the work in this area. These can be summarised as:

[1] Council Directive 2009/119/EC

i. 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;

ii. 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 UK;

iii. The composition of emergency stocks in the UK should, so far as is reasonably practical, reflect the domestic consumption of these products in order to ensure the UK is able to respond to global and domestic supply disruptions quickly;

iv. As far as possible products should be held in a number of different locations within the UK, to provide further resilience;

v. As far as is reasonably practical, recognising the importance of providing resilience, the UK approach to stockholding should be efficient and represent value for money.

What government consulted on

1.5. The consultation was in two parts: firstly on the future management of the Compulsory Oil Stocking mechanism in the UK, and then a wider call for evidence on possible options to enhance resilience through amendments to broader UK CSO policy.

1.6. Part One considered whether the current approach to managing the CSO in the UK meets our objectives for a resilient stockholding policy in the UK, and set out a proposed alternative model through establishing an industry-owned, industry-operated CSE in the UK. Two options for such a CSE were considered; one where membership of the CSE is mandatory for all obligated companies, and one where membership is on a voluntary basis.

1.7. Part Two called for evidence on the costs, benefits and feasibility of introducing broader changes to the UK oil stocking policy, which could apply under any future CSO mechanism. This section asked questions covering a range of issues, including:

- **Type of stocks held:** including whether the proportion of stocks held as finished product, currently set at a third of the total obligation, provides sufficient resilience; whether this should be revised, and; whether the product range from the EU Directive the UK has chosen to obligate on is appropriate.
- **Location of stocks:** including whether there is a case for limiting the quantity of obligated stocks that can be held outside of the UK, and also whether there would be benefit in government providing clear guidance on where stocks should be held within the UK itself.
- **How stocks are released:** in particular whether if a CSE were established in the UK should it, in the event of a stock draw, be required to first offer stocks to member companies.
- **Who owns stocks:** this sought initial views on whether DECC should review the range of companies obligated and the differential in the level of obligation set on refiners and

non-refiners. This was to inform more detailed work on these issues to follow separately.

- **What level of stocks are held:** seeking views on the costs and benefits of holding stocks above our international obligation, to mitigate the impact of smaller scale domestic disruptions.

Summary of responses to consultation

Part One

1.8. In response to questions about moving to a more centralised model a large majority of respondents to the consultation agreed that the UK should establish an industry-owned, industry-operated CSE. Respondents argued that this could bring several benefits. A CSE could manage the CSO more strategically, allowing companies to more effectively plan meeting their obligations. It would help improve transparency of CSO costs. Also, a CSE could help incentivise the development of storage capacity in the UK, through enhanced co-operation and better access to finance. A CSE would also be able to better manage the impact on the CSO of any future changes to the market helping to ensure that obligations continue to be met effectively and efficiently. Almost all respondents argued that for such benefits to be realised membership of the CSE would have to be mandatory for all obligated companies.

1.9. However, some respondents raised concerns alongside these proposed benefits about the governance of such a CSE. Its independence as an industry-owned, industry-operated body was seen as important, but without good governance there was a perceived risk that a CSE could lead to higher overall CSO costs which may then be passed on to the end consumer. It was also noted by some that care needed to be taken to ensure that all obligated parties were heard within the CSE, and that it could not be dominated by any one party.

1.10. Many respondents noted that a CSE would need to be established in stages, but most felt that in the first instance it would make sense for a CSE to take on 25% of the obligation put on companies and that it should have the end goal of taking on 100% of the obligation. The criteria against which the success of a CSE would be measured during this transition were still to be considered, but many felt that this could be done more swiftly than the 5-10 years outlined in the consultation.

Part Two

1.11. In response to questions about broader changes to UK CSO policy the large majority of respondents, particularly many from within industry, raised concerns about changes here. In part this was seen in the context of the UK being in a period of transition for CSO, following the switch to a new EU Directive transposed in December 2012. Also they felt the possible establishment of a CSE would need to be factored in. In particular many industry respondents raised general concerns about holding more of the obligation as finished product (beyond the one-third required by the new EU Directive) or limiting what could be held outside of the UK, positing that this would significantly increase the costs of CSO to them, which they would then have to pass on to the end-consumer. Several argued that it would not significantly add to the UK's resilience through its ability to mitigate supply disruptions, as it could potentially risk increased non-compliance with obligations and may reduce the flexibility of any response. Many respondents were also concerned about any gold-plating of the EU Directive. In particular strong concerns were raised about holding more stocks than those required by our international obligations in order to mitigate smaller, localised, disruptions, due to the increased costs and because it was felt the UK already responded well to local disruptions.

1.12. There was, however, an indication from a smaller number of respondents that increasing the volume of stocks or ensuring a geographical spread of stocks across the UK could result in increased resilience, especially in response to domestic disruptions. Some respondents also pointed out that there are certain considerations that should be taken with regards to particular fuels. For example aviation fuel stocks required particularly strict – and more expensive - quality control conditions. Jet fuel may also be more straightforward to tanker in-flight from outside of the UK in the event of a supply disruption. The UK's over-supply of petrol, but short-supply of diesel and jet fuel, was also something respondents felt should be kept in mind if changing the levels of obligation on particular products.

1.13. Several respondents noted that it was important that stocks held in the UK have good access to the UK supply chain, so that stocks could get to market effectively in the case of a supply disruption. This was also commented on with regards to the development of any new storage capacity in the UK.

1.14. The consultation also sought views on whether the current range of companies obligated was suitable, and whether there were particular issues DECC should consider with regards to the differential in obligation between refiners and non-refiners. In general respondents felt that the current range of companies was suitable for now, although several felt that DECC should continue to keep this under review. On the differential there were strong but divergent views from those who responded to this question, but broadly those obligated at a lower level wanted to see the differential maintained or increased, while those obligated at the higher level wanted the differential removed or reduced.

Summary of Government Response

Part One

1.15. Considering the potential benefits government agrees that an industry-owned, industry-operated CSE with compulsory membership would be a better way to manage the CSO in future. The current system ensures the UK maintains capability to release stocks if required, but there are ways this mechanism could be improved to enhance its efficiency in future. However, there remain several issues, not least regarding the governance of such a CSE, that will need to be considered further before government can consider moving to a legislative phase, which will be required to establish a mandatory body. Therefore the appropriate next step will be for all obligated parties to work together to prepare a 'roadmap' for the establishment of a CSE, for government to then consider. Some thinking on a roadmap has been conducted by industry in previous years, but it is important that this now involves all obligated parties. The organisation and management of the roadmap should be for obligated parties as this will lead toward an industry-owned, industry-operated body. However, to assist, we have set out below the key issues a roadmap should consider.

1.16. First, the roadmap should set out clearly how the CSE will ensure it operates in a fashion compatible with the aims and requirements of CSO, for example the definition of a CSE in the EU Directive and the five guiding principles set out in the consultation document for UK oil stocking policy. The roadmap should explain clearly how the CSE will ensure that stocks are accessible and available at all times, and that reporting on this is clear and transparent. It should also set out how the CSE would operate and in particular how it will ensure that all obligated parties are involved in the CSE and fairly represented. Good governance of the CSE is very important, to both ensure that all members' interests are considered fairly but also that the CSE acts in the best interests of the end consumer. The roadmap should also set out the criteria on which the CSE will be assessed to decide if more of the obligation can be passed on to it, including how it will be clear that the CSE is ensuring the CSO is being managed in a way that ensures value for money to obligated parties and the end consumer. A key benefit of a CSE is that it should help incentivise increased development of storage for oil stocks in the UK; the roadmap should set out how the CSE will do this. Stocks must be well-located to ensure appropriate and useful access to the supply chain.

1.17. Government is keen to move forward with a CSE swiftly, and this is dependent upon obligated parties preparing a roadmap in good time addressing the issues set out above. If the UK government is convinced it presents a robust approach, then it will seek to take forward the necessary legislation as soon as parliamentary time allows.

Part Two

1.18. With regards to the broader questions on resilience, government has noted that many respondents have strong concerns about the impact of changes in these areas, particularly the potential for high cost impacts. Government agrees with respondents that this is a period of transition for CSO, and that the establishment of a CSE could potentially play a role with any future changes in this area. Given this government does not propose to make further specific changes at this time.

1.19. But government continue to hold to our guiding principles set out above; of particular relevance here is that government is of the view that resilience would be better served by having more stocks held in the UK, and that this should reflect so far as is possible the consumption of these products to allow for an effective response to any supply disruption. But government also keeps in mind the principle that so far as reasonably practical the UK approach should be efficient and represent value for money. Government will continue to consider the resilience arguments, but will need more information from industry regarding costs of these possible future changes. Responses on these issues contained limited quantitative data and government intends to discuss this further with industry subsequent to this response. As set out above, the guiding principles for CSO policy should be considered in development of the CSE roadmap as well.

1.20. With regards to the differential, government has taken on board the views raised and, as indicated in the consultation document, has commissioned independent research on this to help inform future decision-making.   It is the government's aim that any decision will be announced by the end of 2014.

2. Introduction

Purpose of this document

2.1. The UK holds emergency oil stocks in compliance with international obligations set by the European Union (EU) and International Energy Agency (IEA) to help ensure resilience to international supply disruptions. The total level of the obligation is set in the EU Directive at whichever volume is higher; 90 days of average net daily imports, or 61 days of average daily inland consumption. As required by the EU, DECC must also ensure that one-third of the obligation be held as stock of the UK's most critical fuels – petrol, diesel, and aviation fuel. Currently the UK directs companies who supply over 50,000 tonnes of oil to the UK market in a year to hold oil stocks in order to meet the obligation.

2.2. However, the total obligation may increase in future, there are concerns that the current system may not adequately encourage investment in storage capacity in the UK and there may be economies of scale that can be realised to ensure the obligation is met in an efficient and effective way. Industry had also indicated that they felt a more centralised approach could be a more efficient and transparent way of meeting the obligation.

2.3. Government felt that these issues were worth exploring further and launched a consultation on the future management of the compulsory oil stocking obligation in the UK, which ran from 4 April 2013 to 7 June 2013. This document summarises the response to the consultation and presents the Government Response.

Stakeholder Engagement

2.4. On 23 April 2013 DECC held a roundtable event for CSO stakeholders. The event was attended by around 40 stakeholders, representing approximately 30 companies, as well as DECC officials from policy, legal, economics and statistics teams. The companies attending included refiners, importers, trade associations, industry analysts and retailers. At this event a presentation was given on the CSO consultation to outline the key issues and questions and to seek any initial views, under Chatham House rules. The CSO consultation was also presented to the DECC Downstream Oil Industry Forum on 15 May 2013. Throughout the consultation period DECC has offered stakeholders the opportunity to ask questions and has met with several stakeholders.

2.5. DECC received 24 responses to the consultation. Respondents came from across industry and the public sector; a full list can be found at Annex 2.

Structure of this document

2.6. This document has two main sections to reflect the two parts of the consultation.

- Chapter 3 presents a detailed summary of the responses to the questions raised on options for the future management of the obligation, in particular the option of the establishment of a CSE in the UK, and sets out the government response.
- Chapter 4 will turn to Part Two of the consultation, a wider call for evidence on resilience options around the CSO. This has grouped the questions into broader categories – types of stock, their location, how they are released, who holds them and how much is held – and for each will summarise the responses to the consultation, and the government response.

3. Part I: Future Management of the Compulsory Stocking Obligation

The first part of the consultation sought views from respondents on the case for changing how the Compulsory Stocking Obligation (CSO) is managed in the UK set out by DECC in the consultation document, and then on options for managing the CSO in the UK, in particular an industry-owned, industry-operated Central Stocking Entity (CSE).

The case for change

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?**

Summary of responses

3.1. The large majority of respondents confirmed that they agreed with the case for change presented in the consultation document and agreed with the cost-benefit analysis set out in the supporting Impact Assessment. They agreed that given the potential increase in the compulsory stocking obligation going forward there was a strong case to review the way in which the obligation was managed in the UK. They also concurred that tightening storage capacity in the UK, and a lack of incentives to invest in new storage, were issues that needed to be addressed. Industry respondents agreed that the way in which the obligation was managed should also be reviewed given the possibility that economies of scale could be achieved through a more centralised approach. In particular it was pointed out by several respondents that a more centralised approach could help them collectively manage the obligation, and could help make more strategic decisions about storage investment in the UK.

3.2. However, some additional factors were pointed out by respondents to further contextualise the case for change in the UK:

i. Several respondents pointed out that currently in the UK there is existing storage that is not used, which could be brought back into service, including salt caverns[2]. Respondents pointed out that these sites could potentially be a lower cost storage option for a CSE. But many of these sites would need additional infrastructure installed to

[2] Reference here was also made by some respondents to infrastructure run by the Oil Pipelines Agency.

ensure they are accessible on a daily basis, as required by the EU Directive. Some respondents pointed out that this existing storage could diminish the incentives for building new storage, but others pointed out that these sites should encourage a swift transition to a CSE approach, to ensure it could potentially invest in these sites before they are beyond repair.

ii. Some respondents argued that further market factors should be taken into account, in particular the impact of the market being in either backwardation or contango on the willingness to hold stocks. The argument respondents put forward was that when the market is in backwardation, companies have less incentive to hold stocks even if they have spare storage capacity, as the product in storage is expected to diminish in value. This can reduce the amount of tickets in the market, increasing the cost of these and therefore the cost of meeting the obligation. It was argued that a CSE could take a more 'unhedged' position, to mitigate these market impacts.

3.3. Several respondents also took this opportunity to indicate that in their view the current system of managing the CSO was non-transparent, particularly around CSO costs. This was largely because there was no way to take a co-ordinated and strategic view; costs for CSO could not be disclosed, and companies had to hold individual buffer stocks to mitigate the risk of non-compliance. The ability to plan CSO costs more effectively would help reduce risk. Some argued that this lack of cost transparency could lead to an uneven playing field, and present a barrier to entry for new players in the market.

3.4. There was also a broader position put forward by some respondents that great care needed to be taken to ensure that in making changes, the end consumer was taken into account. This was particularly with regards to the possibility of a more centralised approach (see paragraphs 3.15 and 3.26).

3.5. The particular requirements for storing different fuels were also noted as a factor to keep in mind by some respondents. In particular jet fuel stocks were considered to have more complex stocking requirements.

3.6. A respondent also questioned, given the concerns about a lack of transparency in the market, how our figures on UK storage capacity in the Impact Assessment were reached.[3] The impact of safety legislation – in particular following the Buncefield incident – on the incentives to invest in storage was also raised as a factor, with the implication being that the UK has stricter safety requirements and therefore higher costs for storage. One respondent suggested that stocks that are held toward the CSO should be duty suspended, in order to help incentivise storage.

3.7. One respondent also raised concerns about the availability of heating oil in the UK during long winters, and suggested that government should consider setting up compulsory stocking obligations for heating oil in the UK.

[3] DECC's figures are our own estimates which combine a variety of publicly available sources. We have checked this again and included revised figures in the final Impact Assessment.

Government response

3.8. Government has noted that there is broad agreement from respondents with the case for change presented in the consultation. Government has also taken note of the additional factors set out by respondents, and the points raised about the impact that mothballed storage and existing storage that may close in coming years could have on the development of new storage in the UK. The availability of this storage capacity is something that should continue to be considered. From a resilience perspective, as our guiding principles set out, having more stocks held within the UK would help improve resilience, but so far as is possible the CSO should continue to be met in an economically efficient manner. Given this development of total storage capacity in the UK is important to meet expected future demand, and it is important that options to do this at best cost are considered. However, the level to which this existing storage is accessible at all times will be a critical factor in determining storage options going forward.

3.9. DECC keep the impact of market factors such as backwardation under review in order to better understand the market and will continue to do so. Companies should already be considering these factors in their CSO management strategies, to ensure that they continue to be compliant with their obligations. Government has considered the other factors raised in developing our revised impact assessment.

3.10. The government takes the supply of fuel to off-grid consumers very seriously. However, as the CSO is an international obligation to respond to significant global supply disruptions government does not consider it appropriate for heating oil to be a specific component of it. DECC is already engaged in work to help off-grid consumers.

Proposed approach – broader scope

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?**

Summary of responses

3.11. The very large majority of respondents noted that they felt the UK should move to a more centralised means of managing the obligation. Most industry respondents feel that a centralised approach could help mitigate problems they saw with the existing system, which could be exacerbated with increases to the obligations going forward. Some respondents pointed out that a potentially increasing reliance on the ticket market going forward could mean that the cost of CSO would be more volatile, with a more centralised approach reducing this volatility. As noted in response to question one, several respondents pointed out that a centralised approach could be more transparent on CSO costs, which could reduce barriers to new market entrants, and, some argued, could reduce the chance of future market exits. Another respondent pointed out that increased transparency brought about by a centralised approach may help gain a greater understanding of stock levels across the UK. Many respondents agreed that a centralised approach would offer economies of scale, not least with regards to investment in storage.

3.12. Increased incentives to invest in storage in the UK are seen as a particularly important reason to move toward a centralised approach such as a CSE. Several respondents posited that the current system does not incentivise investment in storage, with the use of the ticket market being more attractive. Companies were unlikely to invest in storage in the UK, particularly to meet their obligations, as this offered insufficient return on their investment; also there was a great deal of uncertainty about the long term need for storage in the UK. The enhanced transparency coming with a centralised approach could help companies take a more strategic approach to the CSO and storage in the UK. A centralised approach was seen by a large number of respondents to offer the opportunity for obligated companies to pool their resources toward storage; a CSE would likely, as a collective, have better access to finance and at better rates. One respondent also wondered whether a centralised approach may also help encourage sharing of storage capacity across a wider range of companies and increase the potential for development regionalised storage.

3.13. Many respondents also pointed out that a benefit of a more centralised approach would be a more efficient use of the ‘buffer stocks’ held by obligated parties toward meeting the obligation. Under the existing mechanism many companies hold significant extra stocks in order to ensure they are compliant at all times. The view put forward was that a co-ordinated approach would allow this buffer to be pooled, reducing the total amount needed to be held without reducing resilience. Some respondents pointed out that for independent storage operators, strategic storage yields less return than commercial storage, as it was less likely to move in and out of storage. This means that investment in CSO storage is less likely. Increasing clarity in the CSO market, in particular around the long term demand for storage in the UK, may help add incentives to invest here.

3.14. A small number of respondents did suggest that in time it was possible that an increase in the price of tickets would lead to a switch to investment in storage instead even if a CSE were not in place, given individual companies will continue to find the most cost-effective way of meeting their obligations. It was noted though that an effective CSE may help reach this point more quickly by making the case for investment in storage more effectively.

3.15. However, concerns were raised by some about risks to consumers that could be brought about by a move to a more centralised approach. In particular there was a concern that a CSE could, without proper governance and regulation, lead to the establishment of a non-competitive monopoly on CSO. A respondent noted that while in theory a centralised approach should lead to a more efficient system and reduce costs to consumers, experience in other countries had found the costs were not always transparent and there was significant variety in costs. A respondent reflected on a risk that without proper governance a centralised approach could lead to higher CSO costs being passed on to the end consumer. The question as to the level of government involvement was also raised by a few respondents; although many emphasised the importance of the independence of any central body, some respondents maintained that a certain level of government involvement would be needed to ensure regulatory requirements were met and the interests of the final consumer were considered.

3.16. Several respondents also argued that a more centralised approach could help manage the impact of any future market exits of obligated companies. A CSE for example could take a co-ordinated view on how to ensure that despite a market exit of an obligated company the overall obligation is maintained, and sharing any additional burden fairly across obligated companies.

Government response

3.17. It is clear the large majority of respondents agree that there would be benefits in moving to a more centralised approach of managing the CSO in the UK. Government agrees that there are benefits in a more centralised mechanism going forward, and this fits well with our five guiding principles for CSO policy in the UK. Such an approach could incentivise the development of more UK storage and bring economies of scale, while ensuring the obligation continues to be met going forward.

3.18. Government acknowledge the important concerns raised about the governance of any centralised approach and agree that these must be taken seriously in the development of such an approach. The EU Directive requires that any CSE must be a not-for-profit body, acting in the common interest; it is very important to government that in ensuring the obligation continues to be met, the best interests of the end consumer are also well served.

Proposed approach – a Central Stocking Entity

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?**

Summary of responses

3.19. As reflected in the previous section there was a large degree of support for taking a more centralised approach to meeting the UK oil stocking obligations. In the consultation government sought views on whether an industry-owned, industry-operated CSE would be a more efficient model. The large majority of respondents agreed that such a model would be a desirable way forward.

3.20. A very small number of respondents pointed out in their responses that in their view a government run approach may be preferable to an industry-owned, industry-operated model, because energy security is a national concern. However, these respondents also suggested that an industry owned, industry operated model was still a viable model.[4]

3.21. The benefits of an industry-owned, industry-operated CSE were very much as outlined in response to earlier broader questions regarding a centralised approach (see paragraphs 3.11 – 3.13). The majority of respondents felt that such a CSE would be able to have better access to finance and potentially at better rates, than individual companies would be able to secure. Being able to spread the costs and investment risk of new storage across a wider group would also help encourage investment here. This would help incentivise increased development of UK storage facilities. Also, a CSE could increase transparency of the CSO market, allowing for better business planning and reducing barriers to entry to the market for new players. This would help ensure that the CSO was managed more efficiently going forward. It would also be able to better manage any future market exits, to help ensure the obligation continues to be met and that any changes in costs to remaining members are managed fairly.

3.22. It was pointed out by almost all respondents that these benefits would only come if membership of the industry-owned, industry-operated CSE was mandatory for obligated companies. It was argued that without a mandatory approach it would be impossible to establish a level playing field. For example, if it were not mandatory then the set-up fees for the agency would not be evenly spread across all obligated companies. A key issue that was put forward was that many companies may choose to continue to focus on international tickets whilst they remained a cheaper option, and only look to be involved in a CSE once it could provide a cheaper alternative. As well as meaning companies could choose when to join, respondents also noted that companies could also choose to leave if it suited them. These factors would mean that the CSE would have unstable membership, making it very difficult for it to plan its approach to the CSO and storage development, and limit its ability to access better credit at better rates.

3.23. As the large majority of respondents were in very strong support of a mandatory approach, and felt that a voluntary approach would not be viable, in general they could not see any incentives that would make membership attractive in a voluntary model. However, a few, largely non-industry, respondents thought that it would require financial incentives, such as tax breaks or loan guarantees, to encourage membership.

[4] The option of a government run mechanism was not part of the consultation. The expertise for holding stocks lies with industry. Also a government owned approach would be a significant cost to the Exchequer. However, this option was considered as part of the impact assessment analysis that accompanied the consultation document.

3.24. In general respondents noted that they agreed with the costs and benefits of an industry-owned, industry-operated CSE as set out in the Impact Assessment accompanying the consultation, so long as membership of the CSE was mandatory, and the points raised earlier about its governance were taken into account. The main additional costs of a CSE would likely be those needed to set it up. Several respondents noted that costs may be higher in the first instance, but that this was acceptable given the long-term efficiencies this would bring, although one respondent did point out that these costs would need to monitored carefully as a CSE was set up.

3.25. The independence of a CSE was seen by many respondents to be important. It was argued by several respondents that although it needed clear goals – for example taking on the full obligation – it needed to be able to be flexible in its approach. This being said, government involvement was seen by some respondents to still be important; some respondents posited that ‘implicit government guarantees’ would help the CSE.

3.26. The governance points raised before were noted here as well, with some respondents again noting that a CSE would need to be carefully governed to ensure that the end consumer’s interests were taken into account. Some respondents also pointed out that it would be important that in any centralised approach all obligated parties had a voice in decisions. There are a variety of types of company who are obligated, but it was noted that care needed to be taken to ensure that no one group could use a CSE to their benefit whilst to the detriment of others.

3.27. In the consultation DECC presented a draft timetable for establishing a CSE and for it taking on a progressively larger proportion of the obligation, starting at around 25%. This was set up in two phases, each of 0-5 years. Most respondents agreed 25% of the obligation was a good starting point, but several questioned the amount of time needed for the transition. Although a prudent approach was needed, and enough time would be needed to ensure any transition did not have adverse effects, several respondents felt there was scope to reduce the timetable.

Government response

3.28. There is a high level of consensus behind the proposal to establish an industry-owned, industry-operated Central Stocking Entity in the UK. Such a CSE could better manage the obligation in future, incentivise the development of UK storage capacity for oil stocks and provide economies of scale for companies in meeting the obligation, including by increasing cost-transparency for CSO obligated parties. These benefits can only be effectively acquired if the CSE has mandatory membership for all obligated companies.

3.29. Government takes the points raised in response to the consultation regarding the importance of good governance of a CSE very seriously, and wish to ensure that the interests of the end-consumer are also taken into account. This is an issue that will need to be considered further and conclusions reached ahead of the establishment of a CSE.

3.30. Given this government has concluded that an industry-owned, industry-operated CSE with mandatory membership should be established in the UK so long as government can be assured that the issues raised above are addressed. Before government can agree to legislate for this there are still important issues to be addressed. Therefore the appropriate next step will be for obligated parties to work together, while ensuring that they maintain the capability now to respond to a stock release under the current mechanism, to collectively prepare a roadmap for a mandatory industry-owned, industry-operated CSE, to outline how a CSE will be established, how it will be managed and how it will take on an increasing proportion of the obligation. Government is aware that some in industry have done some exploratory work in previous years on how a CSE could be established, but it is important that this work involve all obligated parties who would be members of such an industry owned and operated CSE. If this roadmap provides a robust approach that assures government that the issues above are addressed, then it will take the necessary steps to develop the primary legislation required to establish such a body in law, as soon as parliamentary time allows.

3.31. Although the roadmap will be for obligated parties to manage, government considers there are several issues it should cover. First, the roadmap should be clear how the CSE will ensure it operates in a fashion compatible with the aims and requirements of CSO, for example the definition of a CSE in the EU Directive and the five guiding principles set out in the consultation document for UK oil stocking policy. The roadmap should explain clearly how the CSE will ensure that stocks are accessible and available at all times, and that reporting on this is clear and transparent. It should also clearly set out how the CSE would operate and in particular how it will ensure that all obligated parties are involved in the CSE and fairly represented. Good governance of the CSE is very important, to ensure both that all members' interests are considered fairly but also that the CSE acts in the best interests of the end consumer. The roadmap should also set out the criteria on which the CSE will be assessed to decide if more of the obligation can be passed on to it, including how it will be clear that the CSE is ensuring the CSO is being managed in a way that ensures value for money to obligated parties and the end consumer. A key benefit of a CSE is that it should help incentivise increased development of storage for oil stocks in the UK; the roadmap should set out how the CSE will do this. Stocks must be well-located to ensure appropriate and useful access to the supply chain.

3.32. Obligated parties should also consider the issues raised from the call for evidence in Part 2 of the Consultation.

3.33. Government agrees with respondents that the goal of this CSE should be to, in time and so long as it is working effectively, take on management of the full obligation. It is clear that there is broad consensus that a starting point of 25% of the obligation would be appropriate, and government agrees that this should be considered as a starting point for the work on the roadmap. It is also clear that industry feel there is scope for the timetable for such a transition to be accelerated over that set out in the consultation document. A faster timetable could be considered, so long as this does not jeopardise meeting the obligation, or reduce the benefits of a CSE, for example the development of increased storage in the UK, and this should also be considered as part of the work on the roadmap.

4. Part II: Call for Evidence on Resilience Options

The consultation also included a broader call for evidence on whether more general changes to UK compulsory stockholding policy could potentially improve domestic resilience to oil supply disruptions.

Form in which stocks are held

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?**

Summary of responses

4.1. Many industry respondents were keen to set these questions regarding possible changes to CSO policy in the context of both the recent changes in CSO policy brought about by the new EU Directive[5] and also the potential establishment of an industry-owned, industry-operated CSE in the UK. It was argued that with the new EU Directive

[5] Council Directive 2009/119/EC; Article 9(5).

only coming into force at the end of 2012, including the requirements it had established to hold a third of the obligation as finished product, it would be very difficult to make an accurate assessment of the impact of further changes to the CSO, until the new Directive had been given time to bed down. It was also noted that further changes would be costly to companies, as they would not have been able to plan for these changes when making long term deals on products. It was also argued by many industry respondents that if a CSE were to be established then any changes to the obligation should be taken with that in mind, and should be considered within its establishment and during the transition to it taking on the full obligation. A CSE could take a more co-ordinated view on these issues to ensure their impact was well understood and any transition was managed effectively.

4.2. In general industry respondents felt that holding one-third of the obligation as finished product, as required by the new EU Directive, provided a good level of resilience. Several pointed out that this product could be used as a first response to any supply disruption, with some noting that then more product could be processed at UK refineries in order to meet on-going demand. Unrefined product in their view gave more flexibility – although it should be noted that one respondent questioned how quickly and effectively crude could actually be refined in a supply disruption. There were strong concerns about holding a greater proportion of compulsory stocks as finished product than required under the EU Directive. It was argued that it would not necessarily increase resilience as it could reduce flexibility. The lack of storage capacity in the UK, particularly for certain products like aviation fuel, meant that it could also be practically difficult to store significant additional amounts of finished product in the UK. Respondents from industry also noted that holding more finished product would significantly increase the cost to them of CSO, as finished product is more costly than crude and it would reduce their flexibility in meeting their obligation. This increased cost would have to be passed on to the final consumer. However, limited data was provided for the actual cost impact of this.

4.3. Several responses made clear that there are particularities for certain products that should be considered. Aviation fuel in particular was noted as being very expensive to hold in storage, as there are very strict quality control conditions on it and if it is held in storage for a long time expensive additives are required to be added to avoid it degrading. Also if held as stocks for long periods it may require recertification, adding further cost. A small number of respondents also pointed out that jet fuel had the ability to be flown in if there was a supply disruption in the UK, meaning the market could respond in the short term to supply disruptions. Some products had different shelf lives too, which would also affect the cost of holding them. One respondent commented that as the UK is long on some products (petrol) and short on others (diesel), it could be helpful to have more storage of those the UK is short on.

4.4. However, some arguments were made by a small number of respondents for holding more finished product, with some noting that instantly usable fuel at key points in the supply chain could help build regional resilience in UK, and could potentially reduce the complexity of a release if needed in the UK.

4.5. Industry respondents largely felt that there was no case to be made for limiting the amount of stock held outside of the UK. Currently companies are able to hold stocks either in their own facilities in other EU Member States, or arrange for other companies in other EU Member States to hold stocks on their behalf to help cover their obligation. Respondents argued that limiting their ability to hold stocks internationally would reduce their flexibility to meet the obligation, meaning that the costs for CSO would increase and be passed on to the final consumer. Some said that changes here could even lead to an increased risk of non-compliance or even market exit if costs became too high. For multi-national companies it could mean that they were unable to use their own network efficiently. The limited storage capacity for some products in the UK also was a concern raised; several respondents felt that currently it would not be possible to hold all obligated stocks in the UK. Again there were specificities for certain products; in particular jet fuel could more easily be transported in from other countries.

4.6. However, some respondents did put forward the case for holding more obligated stocks in the UK. Some felt that it could help local resilience, if there was a need to access stocks for a UK-centric supply shortage. One respondent also posited the idea of a three-tier model for storage; with the first tier being immediately accessible finished product near demand centres, the second being finished product in locations that could easily replenish the first tier, and the third tier being unrefined product in less accessible locations. The cost of holding stocks would be expected to reduce with each tier.

4.7. The third question in this section was with regards to the product range chosen by the UK that companies could use to meet the obligation. The EU Directive provides two alternative product ranges: one that offers a wider range of products that can be counted toward the obligation, but for which more stock is required to be held (as the stock is subject to a smaller 'multiplier' when calculating returns), and one which has a smaller range of products but requiring less total stock to be held (as a higher 'multiplier' applies to the stocks held when calculating returns). The UK chose the first option to provide companies with the most flexibility in meeting their obligations. There were limited comments on this from respondents. A small number commented that this favoured certain companies over others, as refiners could hold a wider variety of stocks more efficiently, but that as the change had happened recently it was too soon to consider whether a further change was needed. In general, those respondents who answered this question were supportive of maintaining the status quo.

Government response

4.8. As set out in the consultation document in our guiding principles for UK CSO policy, the UK would benefit from holding a greater proportion of emergency stocks in storage sites in the United Kingdom. Government believes this ensures domestic resilience to supply disruptions. Stocks should, so far as is reasonably practicable, reflect the domestic consumption of these products. It is also important that these stocks are accessible and capable of being supplied to market effectively in response to supply disruptions. However, government has taken note of the concerns raised by many respondents about increasing the proportion of stocks held as finished product and any limitations on the ability of companies to hold stocks elsewhere in the EU.

4.9. Many of these concerns related to the potential increase in cost to holding stocks if such changes were made. Although many responses indicated this concern, responses contained limited quantitative data which DECC could use to complete a thorough assessment of the costs and benefits.

4.10. Government agrees with the point made by several respondents that as the UK has only recently implemented a new EU Directive and that we are minded toward establishing a CSE in the UK, the CSO market is in a period of transition. Therefore at this time government does not intend to make specific changes on these issues.

4.11. However, more analysis is needed on the costs and benefits in changes here. Government will continue to consider the questions about how changes to where and what is held could improve UK resilience, but also want to consider in more detail the cost impact of changes. Therefore government will be seeking more detailed data on the costs of changes to UK CSO policy here from obligated parties. In particular government wants to better understand the cost impact of repatriating stocks to the UK and of holding more stock as finished product. Government will also be considering in more detail the resilience issues here.

4.12. There are important particularities to consider with specific fuels. In particular storage of aviation fuel is more costly, and it is easier to transport in from hubs outside the UK if needed. Although the UK currently has good storage of petrol, this is much tighter for diesel and aviation fuel. Views from industry on the costs of increasing the amount of these particular fuels in the UK would be of interest.

4.13. Given a key benefit of a CSE is that it will be able to better incentivise the development of UK storage capacity, this should help, in time, mitigate the concern that increased stocks could not be held in the UK due to a lack of capacity. Government also feels that given the role a CSE may play in this, it is important that obligated parties consider how a CSE might have an effect on these issues, and indeed how it could work towards holding stocks in the most effective way to meet both domestic and international supply disruptions when developing the roadmap set out in paragraphs 3.30 and 3.31.

4.14. The product range option selected within the EU Directive is broadly acceptable at this time, although government notes some concerns about this favouring particular players over others. Therefore although government will continue to keep this under review, at a time when the changes are still relatively new and difficult to assess, government is not minded at this moment to change it.

Where stocks are held

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?**

Summary of responses

4.15. The large majority of industry respondents raised strong concerns about mandatory guidance on the location of stocks. Similarly to concerns raised around earlier questions, the main issue was that it could reduce the flexibility companies have in meeting their obligation, and therefore could drive up CSO costs, which would have to be passed on to the consumer. There were also concerns that UK companies may not be able to effectively use their own UK networks if strict guidance was set out on where stocks could be held in the UK. There were some concerns too that if strict rules about location of stocks were put in place when there was insufficient storage capacity this could push up costs.

4.16. Some commented that in the medium to long term a CSE would be well positioned to ensure that new storage capacity was built in line with resilience objectives and ensured that it was well connected to the UK supply chain. It was also noted that this was another area where it was important that any CSE was well governed, and also that all relevant players were involved in decisions on stocks.

4.17. A smaller number of respondents noted that there could be benefit to some guidance on the location of stocks in the UK to ensure that new storage capacity was built with the supply chain clearly in mind. This would help ensure the resilience of the system. For example, it was noted that any new storage capacity in the UK for aviation fuel would need good links into the supply chain to key UK airports to be useful, especially given the ability of planes to fly-in fuel if needed from international hubs. Given this it was argued that any development of storage should be considered in conjunction with representatives from the relevant industries. Others, including local resilience fora, pointed out that it could be useful to ensure that the obligation was held regionally-close to UK demand centres. It was posited this could help ensure there was instantly distributable fuel reserves to mitigate local supply disruptions.

Government response

4.18. The EU Directive requires that stocks are accessible at all times, meaning it is critical stocks are well connected to the supply chain. From a domestic resilience perspective it is also important that stocks continue to be well-located across the UK. Government agrees with the points made by some respondents that it is important that future storage developments are well connected to the UK supply chain. A CSE may be well placed to consider this, but it must do so in conjunction will all relevant players to ensure that future storage build ensures UK resilience as effectively as possible. These issues should also be kept in mind in developing the roadmap for a future CSE in the UK.

How stocks are released

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?**

Summary of responses

4.19. There were few responses to this question, but those that did respond largely answered in the context of a CSE with mandatory membership being established. They suggested that in the event of a stock draw, if all obligated companies had to be members of the CSE then inevitably they would also be offered stocks in the first instance. No issues or concerns were raised about this approach, if a mandatory CSE was in place.

Government response

4.20. If an industry-owned, industry-operated CSE with mandatory membership is established in the UK following an agreed roadmap it would seem that there are limited issues with requiring the CSE to offer stocks to member companies in the first instance. However, it is possible that this process may be less clear during any transition toward a CSE (when it would not hold 100% of the CSO) and also it may still be important for the CSE to have clear rules on this to ensure it works effectively in a supply disruption. Therefore it would be appropriate that this issue is considered in more detail through the roadmap process.

Who holds stocks

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

Summary of responses

4.21. The question on whether the differential between the obligation on refiners and non-refiners should be increased, decreased or maintained, elicited two distinct positions from industry respondents. In general, refiners wanted to see the differential reduced, whilst non-refiners wanted to see it maintained, or in some cases increased. Those who wanted it maintained argued that refineries still had a minimum operating requirement; therefore the refinery business model that requires holding more stock would mean the differential should remain. It was also argued by some that increases to the obligation would affect non-refiners disproportionately, as refiners have more flexibility regarding what products they can hold toward the obligation. The counter argument by those who wanted to see the differential removed argued that there was still a high cost to meeting this additional obligation, and that minimum operating requirements were still expensive to maintain in a time when margins were already very tight. It was also pointed out that in some cases refiners were in effect acting in the same way as non-refiners, importing finished product at a jetty for distribution to the market, but were having to maintain a higher obligation on this due to the differential, putting them at a competitive disadvantage. One respondent did note that if the market share of refiners reduced significantly the differential may need to be reviewed.

4.22. Regarding the number of companies obligated, the majority of respondents felt that the level at which this was obligated was appropriate. The broad view was that the current 50,000 tonne limit strikes an appropriate balance, covering the majority of oil suppliers in the UK without creating an unnecessarily heavy administrative burden. There were concerns raised about widening the net, beyond increasing administrative time and costs; these included an increased risk of non-compliance and potentially an increased risk of fraud. There were concerns raised by some companies who supply below 50kt that it would be a significant additional cost on them if were to lower the threshold.

4.23. Some respondents wanted to ensure a level playing field which they considered would mean opening the CSO up to all. One respondent felt that this may lead to increased storage capacity being available for stocks; another posited that this could potentially increase resilience by expanding the number of companies holding stocks for emergencies.

4.24. However, some companies did refer to the current small shortfall against the EU obligation, suggesting that because of this DECC should be reviewing ways in which the shortfall could be mitigated, including looking at which companies are obligated. One respondent went further, suggesting that government should look to revise this now, suggesting a reduction in the limit to 10,000 tonnes in the first instance.

Government response

4.25. Government has noted comments from respondents on the differential. The UK's primary objective on CSO is to ensure that the obligation is met but, as is clear in our guiding principles, we must as far as possible ensure that this is done in an economically efficient and fair manner. Therefore government has commissioned an independent research project on the levels of obligation set on different operators in the UK market.

4.26. In our view the impact of a potential industry-owned, industry-operated CSE in the UK should also be considered with regards to the levels at which the obligation is set for different companies. A CSE could potentially affect the case for having a differential and with this in mind government is also seeking evidence through the research project on the impact, if any, on the differential of a CSE being established in the UK to manage the CSO.

4.27. Government also takes note of the concerns about increasing the number of companies obligated. Government agrees that it is unclear what the benefit of change here would be at this time, and doing so would likely increase administrative burden. But government agrees that this should be kept under review going forward.

What level of stocks are held

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?**

Summary of responses

4.28. Although one respondent suggested that increasing stocks here could help with local resilience, in general there was strong opposition to this from respondents who answered this question. There was general opposition to any gold plating of the EU Directive in this fashion, and many felt that it would serve no purpose given that the Directive allows for compulsory stocks to already be used for domestic resilience purposes. The relative lack of spare storage capacity would mean doing this would either be very costly or impossible.

4.29. It was noted that smaller domestic disruptions have been successfully dealt with in recent years, without the need to use emergency stocks, so additional stocks not needed.

Government response

4.30. Government notes the concerns raised from industry here and their view that the UK has been able to weather previous disruptions effectively. Government must ensure that this continues and will continue to keep this under review.

Annex 1: Consultation respondents

BP

British Airways

Buckinghamshire County Council

City of York Council

Community Buying unlimited

Downstream Fuel Association

Essar

Esso

Greenergy

International Aviation Transport Association

Kent Police

Mabanaft

Merseyside Police / Local Authorities Contingency Planning Group

Oil Recycling Association

Petroineos

Phillips 66

Shell

Simon Storage

Staffordshire Council

Tank Storage Association

Total

UK Petroleum Industry Association

Valero

West Midlands Local Resilience Forum

Department of Energy & Climate Change
3 Whitehall Place
London SW1A 2AW
www.gov.uk/decc
URN 14D/105