

PUBLIC CONSULTATION ON THE PROPOSED MODIFICATION TO EMA'S PROCEDURES FOR CALCULATING THE FUEL COST INDEX FOR THE PURPOSE OF COMPUTING THE QUARTERLY VESTING PRICE

Background of Consultation

1. A public consultation exercise on the proposed modification to EMA's procedures for calculating the fuel cost index for the purpose of determining the quarterly vesting price was held from 2 Jan 08 to 31 Jan 08.

2. The modification, proposed by Intercontinental Exchange (ICE), the provider of fuel oil price information for vesting price computation, is aimed at refining the currently methodology for calculating the fuel cost index. ICE proposed that the window timing be shortened from 8 hours (10am to 6pm; Singapore time) to 1 hour (4.30pm to 5.30pm; Singapore time). Only forward fuel oil prices transacted or quoted between 4.30pm to 5.30pm each day during the relevant data-gathering months will be used for vesting price calculation.

3. According to ICE, the proposed change in the window timing will have the following benefits:

- The proposed new window was timed to come after the close of Platt's trading window. Platts publishes daily prices for Asian crude oil and refined products, which are used as pricing benchmarks for buying and selling crude, gasoline, diesel, and other fuel oils. These daily prices are derived based on close-of-market trading for a 30-minute trading window each weekday in Singapore from 4pm to 4.30pm. With the proposed new timing for the window, the market will have a clearer indication of where the fair value for the fuel oil is.
- The London market will be open during the proposed new timing for the window, which will allow for better liquidity and hence more reflective prices.
- Reduction of the likelihood of manipulation of the 3-month forward fuel oil prices for vesting price calculation if the window timing is constrained to an hour as market will police itself with traders focusing their trading activities in that 1-hour period.

Respondents

4. Feedback was received from 4 respondents, viz. PowerSeraya Ltd, Tuas Power Ltd, Senoko Power Ltd and SembCorp Cogen Pte Ltd.

Summary of Feedback Received

5. Concerns were raised on the risks that could arise if the window timing is reduced to an hour. Some respondents felt that the prices derived using the reduced window timing may not accurately reflect a full day's trading activity. Respondents have also commented that the revised window timing might increase rather than reduce the likelihood of price manipulation, since a smaller trade window may allow for concentrated attempts at price manipulation. The full responses received by EMA are attached at Appendix 1.

Decision

6. After careful consideration of the feedback received, EMA finds that the arguments for the proposed modification is not sufficiently persuasive to warrant modification to the existing window. There has been, to date, no conclusive evidence of market manipulation.

7. Moreover, the effectiveness of the recommended change in addressing the potential for market manipulation and to bring about more reflective prices has been questioned and no consensus has been reached. Anecdotal evidence from other jurisdictions as provided by respondents in fact appears to contradict the argument for shorter data-collection time windows.

8. In view of the lack of sufficient evidence supporting the need for amendment to the existing window, EMA has decided to retain the current window i.e. to use the forward fuel oil prices transacted or quoted in the relevant days from 10am to 6pm Singapore time for the purpose of vesting price calculation.

Feedback received from PowerSeraya Ltd

While we interpose no objections over the implementation of the new procedure, however, further clarification on the following matters is requested:

1. Since its implementation in 2003, the Platt's trading window, also known as the "market-on-close" (MOC) assessment, has been met with resistance by industry players. In view thereof, we wish to inquire whether EMA has considered and validated the following issues prior to publication of its proposal:

- 1.1 European market players claimed that the figures reported by Platts after the revised timing window was implemented are frequently inconsistent with actual market levels during the day as the brief, frenetic trading period does not accurately reflect a full day's trading activity.¹
- 1.2 Oil traders say that miscommunication is highly possible, as proven by the Platts and Noble Group dispute in 2005, with traders pressed for time to clinch a counterparty and a deal, while Platts' price reporters and editors struggling to manage all incoming calls, instant messages and shouts of bids and offers during the trading window.²
- 1.3 Traders from Rotterdam and Singapore alike have complained that the limited trade window with its more concentrated timeframe is easier to manipulate. It was reported that some cargo players were said to have introduced drastically higher bids or heavily discounted offers in the last few seconds of the MOC window.³
- 1.4 In 2007, traders in the US spot crude market expressed that the MOC does not produce benchmark prices that are representative of the market but based on deals done just a few minutes before the market closes. They believe that the lack of liquidity during the window undermines the credibility of the Platts pricing methodology. Alternatively, they favor the averaging the prices of trading throughout, which they deem to be more representative of the market than MOC window.⁴

2. The current procedure has been working well since its adoption in 2004. We are aware that sufficient control has been set up under the EMA procedure (i.e. Section 2.2 and 2.3) to ensure that a representative Fuel Cost is determined for the vesting determination. As such, we would like to seek clarification whether

¹ Platts MOC methodology heavily criticized in ARA market bunker, 13 May 2003.
<https://www.oceanconnect.com/public/viewnews.jsp?articleId=6227>

² Platts and Noble Group in dispute about Asian oil pricing. Alexander's Gas and Oil Connections, News and Trends: S& SE Asia, volume 10, issue 15, 17 August 2005.
<http://www.gasandoil.com/goc/news/nts53370.htm>

³ Pricing under fire again after Singapore incident, 19 July 2005.
<http://www.bunkerworld.com/news/2005/07/62348>

⁴ Natural Gas Week, Volume 23, Number 5, 29 January 2007. www.energyintel.com

there had been any cases recorded or studies done which shows that the current procedure is no longer relevant.

3. We further wish to inquire if EMA has considered potential operational problems and additional expenses, if any, in making the switch, both on the part of the government and the market players. An unpopular side effect of the MOC raised was that the shift will mean staying in the office late, whether to catch the pricing action or to provide inputs to what Platts reports at the end of the day. Any administrative changes are likely to incur costs, and if there are any costs to the government, who will bear such cost?

Feedback received from Tuas Power Ltd

We have no objection to the proposed change in the window timing from 10 a.m. to 6 p.m. Singapore time to 4.30 p.m. to 5.30 p.m. Singapore time.

However, we would like to propose EMA to review the pricing behavior after the change implemented in order to ascertain that there is no manipulation of forward price during the proposed window.

Feedback received from Senoko Power Ltd

Thank you for inviting us to comment.

We note the reasons that Intercontinental Exchange (ICE) provided in support of the modification, and agree its concerns on fair market value have merit.

However, a shorter pricing window would affect the flexibility gencos such as Senoko has in managing our fuel hedge positions. While we agree that determining a fair market value for the purpose of pricing the vesting contracts is important, we would like to ask if a 3 to 6 pm window would still be viable.

The advantages of a 3 to 6 pm window are as follows:

- (a) The proposed 3-hour window encompasses the closing of the Asian Platts Window and the opening of the London market which should address the fair market value issue;
- (b) The market would still be fairly liquid within this time frame, rendering the market less likely to manipulation by a few players; and,
- (c) A wider pricing window than what ICE proposed would give more time and flexibility for market participants and their counterparties in managing their hedge positions.

We hope that the EMA would be amenable to our counter-proposal, and look forward to further interaction with you on this matter.

Feedback received from SembCorp Cogen Pte Ltd

We refer to your consultation paper on "Proposed Modification to EMA's Procedures for Calculating the Fuel Cost Index For the Purpose of Computing the Quarterly Vesting Price".

SembCogen disagree with ICE on the point where it says that their proposed changes would reduce the likelihood of price manipulation of vesting contract by constraining the window timing to an hour. We are of the opinion that the one hour window, in effect, gives traders a focus to game during that one hour period so as to influence the setting of vesting prices. Whereas, on the other hand, the existing window timing of 10am to 6pm will be more representing of the market prices by taking a wider range of prices over a period of time and 'dilutes' the possibility of price manipulation by expanding the 'price concentration' window.

Hence, on the basis of a possible price manipulation by the proposed modification, SembCogen do not support the ICE proposal to change the window timing from 10am to 6pm Singapore time to 4.30pm to 5.30pm Singapore time.