FREQUENTLY ASKED QUESTIONS

Quality Premiums and Platts Brent crude assessments

(Latest Update: April 2013)
INTRODUCTION

On March 15, 2013, Platts announced that it would introduce Quality Premiums for Oseberg and Ekofisk crude oil in its North Sea Dated Brent, cash Brent (BFOE) and related assessment processes for cargoes loading from June 2013 onwards. This announcement followed a broad consultation process with the marketplace that extended back more than 18 months, and a formal consultation process that was announced on February 18, 2013.

This FAQ document discusses some of the most commonly asked questions received during the review process. Platts will continue to review the impact of Quality Premiums in its assessment process, and may make further changes as market conditions, and further feedback, warrant. Platts invites all further questions or comments on how QPs are used in its Brent assessment process, or any other aspect of its assessment methodology, europe_crude@Platts.com and pricegroup@Platts.com.

This document, along with other information about Platts’ Dated Brent assessment, can be found online at http://Platts.com/price-assessments/oil/Dated-Brent.

FREQUENTLY ASKED QUESTIONS

■ What is a Quality Premium?

A Quality Premium is a cost paid by a buyer of a crude cargo to the seller, in return for receiving a better quality cargo of crude than guaranteed at time of trade. Under Platts methodology, QPs are to be paid by buyer to seller for the nomination and delivery of Oseberg or Ekofisk into a physical BFOE transaction concluded during the Platts Market on Close assessment process. These escalators will also be considered in the Platts assessment process for Dated Brent, and related instruments as well.

QPs are a mechanism that “closes the gap” between base crudes, and high value alternates, making it more likely that a seller will deliver a high quality crude against commitments to buyers when needed. QPs are already used in other commodity markets where alternative deliveries are part of a physical settlement mechanism.

A QP is the opposite of a de-escalator, which is a cost paid to a buyer as compensation by a seller who delivers an inferior quality cargo of crude than guaranteed at time of trade.

■ Why is Platts introducing Quality Premiums to its Brent assessment process?

Adding Quality Premiums to its assessment methodology is just the latest in a series of steps that Platts has taken to ensure that its Brent crude oil assessments are well positioned to reflect the value of light, sweet crude oil in the North Sea. Platts has taken a leading role in maintaining Dated Brent as a global reference benchmark price for crude oil. Over the past decade, Platts has been involved in discussions at many levels to enhance the Dated Brent assessment mechanism, at times amending the benchmark assessment in order to maintain its relevance in times of ever lower North Sea crude oil production.

Platts reviewed a wide variety of proposals during its consultation process, including proposals that a Quality Premium should be applied for deliveries of Brent/Ninian Blend. Platts has decided not to include QPs for this grade. It is of great importance that Platts assessment processes are consistent, and reflect standard grades of crude oil through time.

Since its launch in July 1987, Platts’ Dated Brent assessment has been designed to reflect the value of light, sweet North Sea crude oil, as embodied by Brent itself. Platts believes it would be counterintuitive for Brent to carry a QP for delivery against physical Brent trading. Moreover, Brent is already competitive within the Dated Brent assessment process, and in recent years has been used to set the value of Dated Brent without further adjustment.

Quality Premiums are intended to increase the relevance of higher quality crudes to Brent, the basis crude, while instruments like de-escalators are similarly intended to heighten the relevance of lower quality crudes to Brent.

■ Will Platts reflect Quality Premiums in its Dated Brent assessment, as well as in its cash BFOE assessments?

Platts will reflect the value of QPs in its benchmark Dated Brent assessment, to maintain balance in the value of both Dated Brent and cash BFOE.

Platts will assess and publish the value of Dated Brent/Ninian Blend, Dated Forties, Dated Oseberg and Dated Ekofisk, as it does today, and without any further adjustment for the value of escalators.

In line with existing methodology, the most competitive grade will be used to establish the value of Platts’ benchmark Dated Brent assessment. From June 2013, relevant QPs for Oseberg and Ekofisk will be factored into this calculation in the final analysis of the published value of Dated Brent.

■ Will there be a Quality Premium for Brent itself?

Platts has twice extended the number of loading grades to the mechanism, Ekofisk, in 2007 to further address production declines in the North Sea. Platts has twice extended the number of loading days reflected in the Dated Brent assessment, from 7-15 days forward to 10-21 days forward, and in 2012 to 10-25 days forward. Other innovations in methodology have included the addition of ship-to-ship deliveries, and a sulfur de-escalator for nomination and deliveries of Forties crude, all aimed at maintaining a robust benchmark.

One of Platts’ key goals is to maintain the integrity of the Dated Brent benchmark. To reach this goal, Platts reviews its price assessment methodology continuously to ensure its relevance in the marketplace, maintaining open communication with the industry and interested parties at all times. As well as developing its own methodology, Platts actively provides intellectual support to other stakeholders in the marketplace in efforts to maintain the integrity of the Brent complex as a whole.

Similar amendments have included the inclusion of Forties and Oseberg into the Brent assessment process in 2002, and the inclusion of a further grade to the mechanism, Ekofisk, in 2007 to further address production declines in the North Sea. Platts has twice extended the number of loading days reflected in the Dated Brent assessment, from 7-15 days forward to 10-21 days forward, and in 2012 to 10-25 days forward. Other innovations in methodology have included the addition of ship-to-ship deliveries, and a sulfur de-escalator for nomination and deliveries of Forties crude, all aimed at maintaining a robust benchmark.

Frequently asked questions

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Why is Platts introducing Quality Premiums in June?

In June 2011, Platts first communicated the idea of applying Quality Premiums to Oseberg and Ekofisk at an open forum, where a longer-term plan for the Dated Brent benchmark was presented to the industry. Platts has since studied the feasibility of the concept, while ensuring that there is ample communication with all relevant sectors of the community, including producers, consumers, traders and exchanges and anyone concerned with the market. Platts has been committed to providing ample notice ahead of the change.

Support for the implementation of escalators grew throughout 2012, as production issues at Buzzard, Elgin and Franklin fields combined with scheduled maintenance across North Sea fields led to a year-on-year decline of around 15% in total BOE output.

Platts believes it is now important to introduce QPs to the BOE mechanism, prior to the North Sea’s regular summer field maintenance period because market distortions have become more visible around periods of maintenance. QPs help reduce the potential for market distortion during periods of reduced supply of crude oil.

Will Platts ensure alignment between its assessment methodology and contract standards like SukO ’90?

As a publisher of price benchmarks, Platts is committed to playing its role in helping to support an orderly market environment. Platts operates an independent decision-making process, based on broad consultation with the aim of protecting the integrity and relevance of its benchmarks.

Discussions have been extensive with many key stakeholders, including futures exchanges, trading institutions, financial institutions and oil producers like Shell, the custodian of SUKOK ’90, a widely accepted industry standard contract determining the general terms and conditions for the sale of BOE crude oils against the cash BOE delivery mechanism.

Why is Platts calculating Quality Premiums using the net difference between Oseberg and Ekofisk and “the most competitive BOE grade,” and not against Dated Brent itself?

Platts will calculate QPs by analysing net price differences between these grades and the most competitive grade of crude among Brent, Forties, Oseberg and Ekofisk during the two full months prior to announcement.

This is because the introduction of QPs into the Dated Brent benchmark and its related instruments might mean that, at times, the Dated Brent assessment will no longer equal the simple lowest assessed crude of BNB, Forties, Oseberg and Ekofisk.

At times when QPs for Oseberg and Ekofisk are higher than the difference between one of these two crudes and the lowest assessed crude of BNB or Forties, the Dated Brent assessment will equal the lowest assessment of Oseberg or Ekofisk, less their respective Quality Premium. Therefore, with Dated Brent potentially being impacted by the Quality Premiums, the Quality Premiums must be calculated using the lowest of BNB, Forties, Oseberg and Ekofisk, not Dated Brent.

For example, if Dated BNB was assessed at $100.70/barrel, Dated Forties at $100.60/barrel, Dated Oseberg at $101.70/b and Ekofisk at $101.60/b, and if the relative Quality Premiums for Oseberg and Ekofisk for the month of loading were calculated as $1.30/b and $1.00/b respectively, the Dated Brent assessment would equal the value of Oseberg, less its respective Quality Premium, since that value would be lower than the lowest of BOE grades.

In this example, Dated Brent would be published at $100.40/barrel, lower than any of the outright assessments for any of the BOE crudes.

What period of time will Platts analyze when calculating Quality Premiums?

Platts has studied a variety of proposals submitted for how QPs could be calculated, and notes a spectrum of support for different approaches, particularly regarding the time spans that could be used to generate QP values. Platts has observed support for a single month of data to be used, as proposed by Platts in February 2013. Platts has also observed support for the use of longer time periods, including up to three months of data. Following analysis of the approaches proposed, Platts has determined that it will reflect two months of data in its published QPs.

Some companies that commented during the feedback process shared views that a shorter period of data could, in theory, contain risk of a distorted outcome during times of short supply. Others noted that any calculation mechanism that contains more than a large proportion of historical data prior to the final month of QP assessment could, also in theory, create a risk that the final month of values might be similarly susceptible to distortion under certain market conditions.

Under Platts’ methodology, QPs for Oseberg and Ekofisk escalators will published at 50% of the net price differences between these grades and the most competitive grade of crude among Brent, Forties, Oseberg and Ekofisk during the two full months prior to announcement.

The QP values will be weighted, with two thirds the value established in the most recent month; and one third the value established in the month before that.

Platts believes this structure will provide a balanced value for Oseberg and Ekofisk QPs. By reflecting two months of assessment data, Platts will capture the value of more than 70 loading days in total, in response to feedback that QPs should minimize any impact of maintenance programs or other disruptions to supply, while preserving Platts’ core aim of ensuring that QPs appropriately represent a prevailing value of crude for prompt physical delivery.

A QP of zero would be announced if the absolute observed price difference between the grades is less than 50 cents/barrel.

Why will Quality Premiums be established at 50% of net value differences?

Quality Premiums are designed to increase the likelihood of higher value crude oils being delivered against a commitment to deliver a base quality of crude oil,
and reduce possible roaming room between a base grade crude, and higher value counterparts. As such, QPs are not designed to capture in full the achievable premiums that exist at any particular moment in time, because premiums will naturally rise and fall through time. QPs are designed to capture enough of that premium to make higher value crudes more likely to be delivered when needed to augment the supply of base grade crude oil.

A QP that fully reflects price differences between crude oil grades could be disruptive, as buyers and sellers might be deterred by a potentially higher value exposure.

For example, if the escalator for Oseberg was determined to be at 100% of the assessed difference between Dated Brent and Oseberg, the expectation of a fall in the price could deter buyers from participating in the BFOE market, for fear of being obliged to take delivery of a cargo that has lost considerable value.

**Why won’t Platts set a Quality Premium if the net difference is less than 50 cents/barrel?**

Data over the past two years also shows that alternate grades are delivered into the cash BFOE mechanism before a full convergence between the value of Dated Brent and the delivered grade is achieved. Therefore, Platts will not announce an escalator if the assessed price difference between grades is less than $0.50/b to account for this observed, existing delivery incentive.