Summary of the second meeting of the Working Group on the regulation of LNG terminals in France

THE REGULATION OF LNG TERMINALS IN EUROPE

08 January 2008

A. Introduction by Colette Lewiner

Following the approval of the minutes of the meeting held on 14 December, the Group would be discussing the different methods of regulation used for LNG terminals. In view of experience in Europe, is one of the two systems - regulated or exempt - preferable to the other? Is it possible for regulated and exempt terminals to coexist in the same market? Could the coexistence of these two systems within the same terminal be envisaged?
It would also necessary to explore further the request from investors and shippers for pricing visibility, trying to identify what was actually needed and how it could be implemented.

B. The regulation of LNG terminals in Europe (Presentation by Walter Boltz)

Walter Boltz feels that the problem currently facing Europe is more one of exploration, production and transmission infrastructure capacity than of actual gas resources. Europe is surrounded by large producers with abundant gas reserves. The major issue is how to get the gas to come to Europe rather than go to the United States or Asia.

In terms of investment, some countries such as the United Kingdom take a liberal attitude based on market forces. On the continent, governments have traditionally tended to take a more proactive approach. Walter Boltz thinks that the two philosophies complement each other: initially, the market players should be allowed to operate; but it is important to reserve the right for national authorities to intervene if the necessary investment is not forthcoming.

It is also necessary to examine the optimum level of investment. For example, following the supply crisis in the winter of 2005-2006, the Italian government defined a margin of 20% surplus import capacity over its peak winter demand. Walter Boltz believes this is an interesting concept, but thinks that the margin should be evaluated according to the needs and situation of each country. For example, it is possible that France, which has better connections with the rest of Europe than Italy, has different needs.
According to Walter Boltz, security of supply depends not just on import capacity. Transparency also plays a fundamental role. The day after the Ukraine crisis in 2006, the companies that wanted to reroute gas to Europe experienced difficulties because there was little public information on the available transmission capacities and their owners.
In years of reference weather, European transmission and import capacities are currently sufficient to ensure security of supply. But as the Italian supply crisis showed, capacities may prove insufficient in more extreme situations.

Some investment is therefore necessary; this will guarantee security of supply and will allow competition to be increased. Because growth in demand for gas is mainly linked to the number of gas-fired power stations that will be built in Europe, there will be a correlation between gas prices, coal prices and emission certificates. Walter Boltz believes that electricity production will contribute 80% to growth in gas demand in Europe.

We might take note of the fact that if all the LNG terminals currently planned in Europe are built, the average use of these infrastructures could drop from approximately 50% to 20% in European LNG terminals. Because this is unlikely, Walter Boltz believes that average use will be around 35 to 40%. In France, average rates for use are higher than in the rest of Europe. However, Walter Boltz recalled that investing in transmission systems and using terminals located abroad may be an alternative solution, with the perspective of creating a Europe-wide market.

In addition, Walter Boltz points out that the majority of the terminals planned in Europe have obtained or are in the negotiation process to obtain exemptions from third party access.
He believes that the Hackberry decision adopted in 2002 in the United States would not necessarily be adaptable to the European gas sector. The American concept is based on the fact that LNG terminals are considered part of the upstream/production chain.

In addition, the European gas sector is more concentrated than the American gas sector and there is no actual separation of assets between the network and large hub allowing prices to form.

If exemptions were granted, according to Walter Boltz it would be necessary to introduce minimum conditions aimed at protecting competition. In particular, the procedures for allocating capacities and managing congestion would have to be controlled by the regulator. The European Commission is currently drawing up some guidelines for the application of Article 22, which according to Walter Boltz will aim to achieve this. For example, Walter Boltz describes the exemption granted by E-Control to the Nabucco gas pipeline as a "balanced" exemption. It provides for an open season, a pricing method approved by the regulator and, ultimately, the construction of additional transmission capacities.

C. Conclusions

The members of the Working Group believe that LNG infrastructure is a good way of encouraging **security of supply** and plays an active part in creating **liquidity in the markets**.

There are two possible approaches for achieving the right level of investment in LNG terminals:
- a centralised approach, requiring planning of market needs and regulation of new capacity;
- a market-led approach, in which investors are free to make their own decisions on the basis that the level of risk is higher.

The Group hopes that the optimum level of investment will not be decided centrally by the administrative or regulatory authorities.
It is also important to underline the fact that **the producer countries are probably more attracted by exporting to liquid, flexible markets than to planned markets.**

Furthermore, the Group stressed that it was important for the market players to have as much information as possible to enable them to make their investment decisions.

In the specific case of LNG terminals, it is essential to ensure fair treatment by the transmission system operators (whether their assets are separated or not) of the connection of planned terminals, regardless of who the investors and shippers are.
To answer questions about the impact of LNG and the terminals on European competition, it would be necessary to look into the real fluidity of the transmission of gas imported into Europe, putting into perspective the gas pipeline projects that have been decided or on which decisions are currently being made. It seems pertinent to be able to identify whether the gas market in France will really by liquid from 1 January 2009, and if not, when it could become liquid.

As regards regulation, it is important to note that not all the operators of LNG terminals want to obtain exemption. Some would rather guarantee their turnover through regulated pricing than take the risks associated with the market. Other operators can deliberately opt for pricing exemption without demanding exemption from access by third parties.

The question remains as to how to provide long-term pricing visibility for an infrastructure with regulated third party access and a guarantee of stability in pricing method?
This subject will be discussed at the next working meetings, but the Group agreed that visibility was essential, both for project promoters and for infrastructure users.

As regards the coexistence of exempt and regulated LNG terminals, the question of how usage prices will change for one sort compared with the other sort could be analysed. This kind of coexistence does not happen anywhere in Europe at present, so it is difficult to know on the basis of experience.
The limits of exemption will also need to be discussed.

The next meeting will discuss the following specific points:

- the various "Use it or lose it" mechanisms (1) put into place: the basics and feedback on their application ;
- the mapping of the interconnected markets. When will we see a fluid European market emerge?;
- the pertinence of the concept of a surplus capacity margin for gas imports and the optimum margin for the French market;
- the coexistence of exempt terminals and regulated terminals, plus information on how regulated American terminals operate.

(1) **UIOLI**: mechanism allowing the operator of the infrastructure to sell unused capacity held by a "primary" operator on the secondary market, for the benefit of third parties.