Qatar Petroleum and ExxonMobil Draft application for a Gas Directive exemption for a proposed LNG terminal at Milford Haven

Initial views

December 2003

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1. Introduction

1.1. In June 2003, the Department of Trade and Industry (DTI) and Ofgem issued a joint consultation document[1]. In that document, we explained that the forthcoming Gas and Electricity Directives were to introduce a regulated third party access regime (RTPA) for interconnectors and Liquefied Natural Gas (LNG) import terminals. The Directives allow exemption from RTPA to be given by the relevant regulatory authorities, subject to veto by the European Commission. The Directives set down criteria that have to be met in order to justify such an exemption being granted.

1.2. In the June document, we explained that it is likely that the Directives will not be in force in the UK until mid 2004 and that it was the intention of the DTI that the relevant regulatory authority would be Ofgem. However, there are several potential LNG and interconnector projects that could be moving to financial close prior to the Directives becoming law. Project developers have requested early informal non-binding guidance as to whether they could expect their particular project to be exempt from a RTPA regime. Ofgem indicated that it would be prepared to give such guidance. However, this decision would need to be informed by consultation on a case-by-case basis. Any such consultation would be on the basis of a draft application for exemption prepared by the relevant infrastructure developer. Of course, formal exemption granting powers will only be available to Ofgem once the Directives have been enacted into UK law.

1.3. It was made clear in the June document that Ofgem shall aim to ensure, as far as possible, that any such guidance issued gives comfort as to the likely regulatory treatment of particular infrastructure. However, any such guidance issued would also be constrained to a significant extent by necessary legal caveats.

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[1] *LNG facilities and interconnectors, EU legislation and regulatory regime, DTI / Ofgem initial views*, DTI / Ofgem, June 2003

1.4. It is also important to note that the new Directives have not yet been implemented into UK law and that any amendments to UK law which are made in order to do so may be different to those currently envisaged. The views set out in this paper may change if the requisite amendments to UK law prove to be different to those envisaged. Interested parties should not rely on this document for any purpose other than as guidance as to the way in which the new Directives may be transposed into UK law and views of how the new regulatory regime may operate.

1.5. In November 2003, the DTI and Ofgem issued final views in relation to the new Directives and the resulting regulatory regime[2]. By and large, the final views document confirmed, and clarified, the position set out in the initial views document.

1.6. Notwithstanding any early guidance issued and consultation surrounding such guidance, Ofgem would anticipate undertaking a formal consultation once it had obtained formal powers and the facility in question formally applied for an exemption.

1.7. The first draft application for guidance was received from Gastransport Services (GTS) for the proposed Balgzand Bacton interconnector pipeline project (BBL) between the Netherlands and the United Kingdom. Ofgem consulted on this draft application in September 2003[3]. Ofgem issued its final views[4] on this draft application in December 2003. We indicated that, as and when formal powers became available to Ofgem, we would envisage granting an exemption from the relevant parts of the Gas Directive.

1.8. The second draft application was received from Qatar Petroleum and ExxonMobil (QP/EM) on 27 November 2003 for the proposed South Hook LNG import terminal at Milford Haven in Wales. A copy of this draft application is attached to this document.

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[2] *LNG facilities and interconnectors, EU legislation and regulatory regime, DTI / Ofgem final views*, DTI / Ofgem, November 2003
[3] *Gastransport Services, Draft application for an exemption for the Balgzand Bacton Pipeline project (BBL), initial views,* Ofgem, September 2003
[4] *Gastransport Services, Draft application for an exemption for the Balgzand Bacton Pipeline project (BBL), final views,* Ofgem, December 2003

1.9. Views in relation to this latter draft application are invited by 9 January 2004 and should be sent to :

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1.10. If you wish to discuss any matters in this document, please contact Kyran Hanks on 020 7901 7021 or Kevin James on 020 7901 7181.

2. Discussion of the request

2.1. This chapter summarises the main details of QP/EM's draft exemption request, the relevant conditions for an exemption, QP/EM's assessment as to how they meet these conditions and Ofgem's initial views.

The exemption request by Qatar Petroleum / ExxonMobil

2.2. QP/EM are planning an integrated project for the supply of gas from the State of Qatar to the United Kingdom. This project, known as Qatargas II (QGII), involves the construction of:

- Production facilities in Qatar;
- Two LNG liquefaction trains at the Ras Laffan industrial city in Qatar;
- Approximately 17 LNG tankers; and
- An import and regasification terminal at South Hook, close to Milford Haven in Wales.

2.3. It is currently intended by QP/EM that the import and regasification terminal will be developed in two phases, consistent with development of two liquefaction trains and associated facilities in the upstream project. The first phase, intended to be about 10 bcm/year, is scheduled to be commissioned in the fourth quarter of 2007. The second phase, also intended to be about 10 bcm / year, is scheduled to be commissioned at a later date, potentially 2010. The life of the project is intended to be at least 25 years. The capacity of the two upstream liquefaction trains together are planned to be 21 bcm / year.

2.4. QP/EM explain that it is possible for Qatari LNG to compete effectively in the European market with other sources of gas. However, they explain that project viability is entirely dependent on costs and risks being kept to a minimum in each element of the integrated project.

2.5. In this light, QP/EM explain that they have investigated the possibility of using a third party terminal. They have concluded that an own use terminal represents the lowest risk for the project and, as such, is the most cost efficient option for the QGII project. They explain that an own use option provides QP/EM with full control over facilities, permitting, engineering and construction thereby enabling the total costs of the project to be minimised.

2.6. QP/EM are of the view that exemption from RTPA requirements is necessary if the project is to proceed to its current schedule to deliver LNG to the UK. QP/EM intends to continue working with the relevant authorities to satisfy them that the project should be exempt. That is, that exemption from the RTPA provisions of the Gas Directive is necessary in order that the project proceed. To support this view, QP/EM have prepared a document explaining why, in their view, exemption should be given. Part of this submission, and its supporting documentation, is confidential. However, a copy of the submission has been prepared for public consultation and is issued with this document.

Conditions for exemption

2.7. The June 2003 document set out the parts of the Gas Directive that can be exempted by the relevant regulatory authority. In brief, exemption is possible from the need for pre-approval either of tariffs (which by implication implies the pre-approval of the revenue and return of the infrastructure developer) or tariff methodologies. Exemption could also imply that there would be no dispute resolution process or ex-post intervention possibilities (although general competition law would continue to apply). Exemption by the relevant regulatory authority is possible if the development meets five criteria.

2.8. The five conditions relating to an exemption are:

♦ The investment must enhance competition in gas supply and enhance security of supply;

- The level of risk attached to the project is such that the investment would not take place unless an exemption is granted;
- The infrastructure must be owned by a natural or legal person which is separate at least in terms of its legal form from the system operators in whose systems that infrastructure will be built;
- Charges are levied on users of that infrastructure; and
- The exemption is not detrimental to the effective functioning of the internal gas market, or the efficient functioning of the regulated system to which the infrastructure is connected.

Exemption criteria applied to the Qatar Petroleum / ExxonMobil request

2.9. The QP/EM draft application gives their view as to each of the exemption criteria.

a) The investment must enhance competition in gas supply and enhance security of supply

2.10. QP/EM have provided a detailed analysis of the nature of the gas supply chain in Great Britain. In terms of the qualitative features of the GB gas market, QP/EM explain that:

- Ofgem is a well established independent regulatory body;
- The British gas market has been fully open since 1998 and that a significant amount of supplier switching has occurred in all market sectors;
- There is non-discriminatory access to a legally separate transmission network;
- There are high levels of competition throughout the gas chain; and
- The European Commission has identified that GB is the most competitive gas market in Europe.

2.11. QP/EM have also provided a qualitative analysis of the GB gas market. In this analysis, QP/EM (as suggested by DTI / Ofgem) have analysed three market segments:

- Upstream (Qatar Petroleum) – QP/EM explain that Qatar Petroleum will be a new entrant to the British market and, as such, had no share of production and supply of gas to GB in 2002. QP/EM explain that Qatar Petroleum's 70% interests in QGII means its forecast share of production and potential supply of gas to GB is about 5% in 2010 and 9% in 2015.

- Upstream (ExxonMobil) – QP/EM explain that ExxonMobil's share of GB production and potential supply was around 15% in 2002. They explain that an analysis of supply, including expected Norwegian imports and LNG, shows that ExxonMobil's share of production and potential supply of gas to GB is forecast to be in the range 5 to 15% through to 2015. At Ofgem's request, ExxonMobil has included a commentary on its interests in N.V. Nederlandse Gasunie, the integrated Dutch gas supplier. ExxonMobil does not consider that its 25% shareholding in Gasunie impacts the competition analysis. ExxonMobil has included these volumes in its analysis of the wholesale market as Gasunie is a redistributor not a producer and the gas is planned to be delivered as processed gas through an interconnector.

- Contractual Arrangements At The Beach (Qatar Petroleum) - QP/EM argue that there is no independent beach market. Sales that are first sales by producers are made at the upstream supply level and resales are made at the wholesale level. In either case, "contractual arrangements at the beach" should include other points of gas sale such as the National Balancing Point (NBP) and interconnectors. In 2002, Qatar Petroleum sold no gas "at the beach" in GB. The contractual arrangements envisaged by QP/EM will involve sales at the upstream level via the LNG supplied to TradeCo[5] ex ship (by Qatargas

[5] Paragraph 2.13 explains this term.

II) and at the wholesale level when TradeCo re-sells the gas ex terminal to ExxonMobil Gas Marketing Europe Limited (EMGME). Market share calculations assume 70% of these sales are Qatar Petroleum's and 30% are ExxonMobil's reflecting the respective shareholdings in the relevant venture companies.

- Contractual Arrangements At The Beach (ExxonMobil) - ExxonMobil describes its existing long term sales as producer direct sales to third party redistributors (or wholesalers) at the beach, NBP and interconnectors. The ExxonMobil equity gas produced by upstream ExxonMobil entities and not committed to third parties is marketed by EMGME, their shipping entity, through resales in the wholesale market under longer and shorter term contracts.

- Downstream (Qatar Petroleum) – in 2002, Qatar Petroleum had no interests in GB. If QGII is implemented, QP would be a new entrant to the wholesale market in GB and its share will be less than 5% when measured against the physical plus traded market and 9% by 2015 when measured against a more narrow physical basis.

- Downstream (ExxonMobil) – ExxonMobil explains that its interests in the wholesale market are also less than 5% when measuring its physical plus traded supplies against the total traded volumes. It does not anticipate this share rising above 5% through to 2015. When measuring its physical supplies against a narrow/physical basis, its market share declines from 15-25% in 2002 to 5-15% in 2015. Beyond 2015, ExxonMobil's share is currently expected to decline consistent with continued decline in North Sea production.

2.12. QP/EM consider that the downstream level of the market comprises gas sold on the wholesale market and gas sourced from producers or wholesalers that is sold to end users at the meter in the power, industrial & commercial and domestic sectors ("retail sales"). At Ofgem's request QP/EM provided analysis of the wholesale market on a narrow basis excluding retail sales met by producers and excluding retraded gas volumes, but argue that the market is much broader. QP/EM also argue that whilst a GB analysis is provided for Ofgem's purposes, the geographic scope of the wholesale market should be Europe-wide by 2010.

2.13. In the DTI / Ofgem June and November documents, we identified three areas that would help to demonstrate that an infrastructure project did enhance competition in gas supply –

- Requirement to offer initial capacity to the market, ie an "open season" requirement – QP/EM explain that own-use terminal developers should not be required to offer initial capacity to market. They consider that an open season process would not benefit customers. They explain that such a process would increase the costs of the project. QP/EM give detailed reasons as to why they have not conducted an open season with respect to the proposed South Hook terminal.

- Use it or lose it arrangements – QP/EM explain that where its capacity is not being used, it could be offered to the market either as longer term or spot capacity. They are proposing that such offers could be made via, for example, an electronic bulletin board. They also propose that the terminal operator ("TermCo" in the draft application) would enable the primary capacity holder ("TradeCo" in the draft application) and any third party to market capacity on a secondary market.

- Appropriate information gathering powers – QP/EM agree to the provision of information to Ofgem where this is reasonably required.

2.14. QP/EM explain that the investment will enhance security of supply in Great Britain. To support this view, they demonstrate that:

- The QGII project will help to offset declines in indigenous production;

- The project will provide a new source of gas, i.e. Qatar;

- The proposed terminal is an additional entry point into Great Britain;

- LNG transportation will provide flexibility of supply source; and

- Qatari LNG is amongst the most reliable energy supply sources in the world.

b) The level of risk attached to the project is such that the investment would not take place unless an exemption is granted

2.15. QP/EM explain that the range and level of risk undertaken by them as a whole is considerable. They ask that the risk in the terminal investment should be seen in the context of the significant upstream investment of which the terminal is a part. They say that investment in the terminal is solely to allow the upstream investment to take place. They say that to justify such significant investment, the shareholders, ship owners and external lenders require guaranteed access rights throughout the supply chain. They conclude that for the entire project to be viable, it is essential that QP/EM can secure, in advance, long-term terminal access.

2.16. QP/EM explain that Qatari gas can only be competitive with other supplies if overall costs are minimised. To achieve this, they say that the terminal facilities need to be matched in terms of scale and operational efficiency with the rest of the QGII supply chain.

2.17. QP/EM explain that they are seeking exemption for 100% of the projected total terminal capacity as this is built in two phases consistent with the phasing of the upstream liquefaction trains. The first phase is currently expected to be for 10.5 bcm/year capacity commencing Q4 2007 with the second phase expected to commence in Q1 2010. An exemption is being requested for 25 years for each phase at startup.

2.18. QP/EM explain that a 25 year exemption is consistent with past European Commission decisions. They also demonstrate that parts of the financing for the entire project will have a 25 year maturity. They have provided the views of Royal Bank of Scotland that, in the absence of an exemption, the financing markets will not be in a position to support the QGII project in the manner required.

c) The infrastructure must be owned by a natural or legal person which is separate at least in terms of its legal form from the system operators in whose systems that infrastructure will be built

2.19. QP/EM explain the terminal operator will be a separate legal entity from National Grid Transco to whose system the terminal will be connected.

d) Charges are levied on users of that infrastructure

2.20. QP/EM explain that tariffs will be charged by the terminal operator on all users of the terminal. It does not propose to publish the charges for own-use. It does propose to publish the charges for third party use.

e) The exemption is not detrimental to the effective functioning of the internal gas market, or the efficient functioning of the regulated system to which the infrastructure is connected

2.21. QP/EM have estimated the proportion of capacity that the terminal will have relative to other LNG terminals in the European Economic Area. On this basis, by 2010, South Hook's share of European LNG capacity has been estimated at about 10%

Ofgem's initial view

2.22. We explained the legal caveats to our guidance above. Against that background, Ofgem's views as to the draft application made by QP/EM are as follows.

a) The investment must enhance competition in gas supply and enhance security of supply

2.23. The DTI / Ofgem documents explain that Ofgem would be looking at qualitative and quantitative factors with respect to competition in gas supply. We concluded that the regulatory authority should establish, at the outset of a new project, on the basis of a number of market indicators that the nature of the project and the relevant market conditions when taken together across the supply chain are sufficiently competitive to allow the grant of exemptions.

2.24. We have considered and agree with the QP/EM views as to the qualitative nature of the UK market. That is, the UK market is the most competitive in the European Union. We note that this view is supported by the European Commission.

2.25. Before coming to a final view of the quantitative analysis provided by QP/EM with respect to this criterion, Ofgem will be undertaking its own competition analysis with respect to the QP/EM draft application. However, at this stage, we have several observations with respect to QP/EM's analysis of this criterion.

2.26. With respect to upstream competition, it is clear that the gas sourced from Qatar, and under the control of Qatar Petroleum, should enhance competition. Qatar Petroleum has no current interests in supplying gas to the UK. Hence, it can be seen as a significant new entrant to the UK upstream market and thus can be seen as beneficial to competition.

2.27. We have considered ExxonMobil's position upstream. ExxonMobil is currently the largest offshore producer of gas in the UK Continental Shelf, with about 15bcm of UK production in 2002. The majority of its production is sold to EMGME. This equity production is forecast to decline significantly by 2010 (6 bcm is the figure included in the draft application). When 30% of QP/EM volumes are attributed to ExxonMobil, its market share of upstream production is still forecast to decline. This position is not significantly altered if 25% of Gasunie volumes are attributed to ExxonMobil. Thus, we can conclude that the South Hook project should increase upstream competition with respect to ExxonMobil.

2.28. In the DTI / Ofgem initial views document, we indicated that we would consider contractual arrangements "at the beach". QP/EM have argued that this is not the most appropriate analysis. Rather, they suggest that Ofgem should be considering the wholesale market, comprising sales at the beach, at the NBP and to the interconnectors. We agree with the views put forward in this area, and the DTI / Ofgem final views document was amended accordingly.

2.29. With respect to competition in the wholesale market, Qatar Petroleum appears as a significant new entrant through its 70% interest in TradeCo which will be reselling gas out of the terminal to ExxonMobil.

2.30. With respect to Exxon Mobil, it has been explained to Ofgem that it is intended that all the gas put through the South Hook terminal will be resold by TradeCo to ExxonMobil. Even counting a 30% share of the TradeCo resale in the narrow/physical description of the wholesale market, ExxonMobil's share of the wholesale market declines through to 2015 and is only in the range 5-15% by the time the QGII Project reaches plateau (2010/2011). In principle, therefore, and assuming no further increases by ExxonMobil elsewhere, competition in the wholesale market would seem to be improved by the connection of the South Hook LNG terminal.

2.31. Ofgem notes the ExxonMobil view that the relevant consideration is ExxonMobil's physical and traded supplies of gas when set against total volumes of traded gas. In such an analysis, ExxonMobil's market share never rises above 5%. However, our view is that the more relevant figure is ExxonMobil's physical supplies of gas when set against total physical deliveries. In this regard, ExxonMobil's market share of 5 to 15%, when set in the context of the current competitiveness of the wholesale market, would seem to give no cause for concern. ExxonMobil explains that its market share of the narrow/physical market is in decline.

2.32. There are several areas however that are being investigated by Ofgem with respect to the wholesale position of ExxonMobil. First, Ofgem are further exploring the extent to which these contractual arrangements at the beach might, or might not, provide ExxonMobil with control over gas flows in order to fully assess competitive impacts in the wholesale level of the market. It has been put to us that ExxonMobil will not have control over the gas flow arrangements as it will enter into a 100% take or pay arrangement with TradeCo.

2.33. Second, ExxonMobil currently has a 25% interest in Gasunie. Gasunie has announced that it is to supply 8 bcm / year of gas to Centrica, possibly via a new interconnector from the Netherlands to the UK. It was proposed that the marketing arm of Gasunie (that holds the contract with Centrica) would be split from the transportation arm of Gasunie (that would construct the interconnector). It has recently been announced that this split has been postponed and it is unclear that a future date for the separation has been set. At this stage therefore, Ofgem thinks it reasonable to assume that ExxonMobil's share of Gasunie should be taken into account when considering the competitive impact on the GB gas market of the South Hook terminal. We have included this above in the upstream analysis, but it could also be considered with respect to the wholesale analysis.

2.34. Third, a further consideration is the extent of ExxonMobil's joint ventures with Royal Dutch / Shell. The European Commission highlighted the nature of this relationship in its investigation into the merger between Exxon and Mobil. This was most recently highlighted by the announcement that ExxonMobil and Shell have agreed to buy gas from Statoil for the delivery of Norwegian gas at St Fergus. It is proposed that the gas be marketed separately. ExxonMobil, at Ofgem's request, has supplied information as to the scope of ExxonMobil's joint operations with Royal Dutch / Shell in the UK, Norway, Belgium and the Netherlands to ascertain the extent to which this commercial relationship might affect any competition assessment with respect to the import terminal at Milford Haven.

2.35. Fourth, QP/EM have proposed anti hoarding arrangements but Ofgem see that another consideration is the decision by QP/EM not to conduct an open season. QP/EM explain that merchant infrastructure developers have found it possible to conduct open seasons. QP/EM have provided arguments in their application as to the differences in their business model and the reasons for their business choice, but Ofgem remains to be convinced as to whether or not an open season would have been appropriate. We understand, and agree, that conducting an open season after terminal design is problematic. However, this would not explain why an open season could not have been conducted prior to terminal design.

2.36. As for downstream competition, it is clear that Qatar Petroleum does not have significant downstream interests in the GB gas supply market. This position is not forecast to change as a result of the project. With respect to Qatar Petroleum, Ofgem agrees that the project will not have a negative effect on downstream competition.

2.37. With respect to ExxonMobil, we note that ExxonMobil has very limited supplies of gas to customers. This is not forecast to change as a result of this project, i.e. ExxonMobil will be selling the gas into the wholesale market.

2.38. As for security of supply, Ofgem considers that the addition of a new source of gas (i.e. Qatar) should be beneficial for security of supply. In addition, the location of the gas (South Wales) should be beneficial for diversity of supply. Finally, the project should provide the potential for increased competition in terms of Transco's transmission support requirements.

2.39. In summary, we have explained Ofgem's current thinking as to the factors relevant to our consideration of the competition analysis put forward by QP/EM as to whether this criterion is met. We have explained that, on the analysis provided by QP/EM, the project would seem to enhance competition in gas supply, as well as enhancing security of supply (including diversity of supply).

2.40. We have explained that a different conclusion might be reached when taking into account ExxonMobil's interests in Gasunie, its relationships with Royal Dutch / Shell, the lack of an open season and the nature of the contractual arrangements between Qatar Petroleum and ExxonMobil. We will continue to discuss these issues with (mainly) ExxonMobil.

2.41. At this stage, some work remains to be done before we are comfortable with coming to a view on this criterion. One way in which our concerns could be addressed would be through the conditions attached to any exemption, or the circumstances in which any exemption could be withdrawn.

b) The level of risk attached to the project is such that the investment would not take place unless an exemption is granted

2.42. At this stage, Ofgem is content with the QP/EM view that the level of risk attached to the project is significant. The proposed level of investment at the terminal is only one part of much more significant investment upstream of the terminal. The state of the world LNG market is at a formative stage. As such, it is not easy to envisage how risks associated with the project can be mitigated other than through some element of long term contractual support.

2.43. QP/EM have provided financial analysis to Ofgem. This indicates that they are likely to seek project finance to support the investment. QP/EM say that the shareholders, ship owners and external lenders require guaranteed access rights throughout the entire supply chain, including the terminal. QP/EM say that such access needs to be guaranteed before investment decisions are taken. An exemption would give assurance that, as long as access was required, it would be available.

2.44. QP/EM go on to say that exemption is requested for 100% of the capacity, for 25 years. Their view is supported by their financial advisors, Royal Bank of Scotland who explain that financing instruments that will support this investment would have durations of between 20 and 25 years.

2.45. Ofgem will be seeking further details on the views put forward by QP/EM and their financial advisors. However, at this stage, we would expect to conclude that this criterion would be met.

c) The infrastructure must be owned by a natural or legal person which is separate at least in terms of its legal form from the system operators in whose systems that infrastructure will be built

2.46. It is clear that the terminal will be fully separate from National Grid Transco. We would therefore expect this criterion to be met.

d) Charges are levied on users of that infrastructure

2.47. Ofgem is content that on the basis that tariffs will be published, this exemption criterion is likely to be met.

e) The exemption is not detrimental to the effective functioning of the internal gas market, or the efficient functioning of the regulated system to which the infrastructure is connected

2.48. Ofgem considers that the connection of the South Hook terminal to the UK system will not be detrimental to the effective functioning of the internal gas market in the UK. Entry capacity to the Transco system will be booked consistent with other entry capacity. We expect any technical implications of the connection, such as gas quality, to be resolved by QP/EM and National Grid Transco. As such, we consider that this exemption criterion is likely to be met.

2.49. We have considered this draft application in the context of the internal gas market in Europe. We note QP/EM's view that the project should be considered in terms of the European market, rather than GB alone. We have not considered this view in detail since our remit is GB only. We would expect this to be an important consideration for the European Commission. However, we would agree with QP/EM that the project should be beneficial for the internal gas market in Europe. As for the GB market, our views have been given above.

Scope of an exemption

2.50. QP/EM have requested that an exemption be granted for full capacity of the terminal (21 bcm / year) and for 25 years. In principle, Ofgem has no objection to giving long-term exemptions and note that this is consistent with European Commission rulings with respect to other projects (particularly the UK – Belgium gas interconnector). However, as explained above, we currently have concerns with respect to the effect on competition of this particular project. Ways to mitigate these concerns could be:

- Granting an exemption for less than 25 years;
- Granting an exemption for less than 100% of the terminal capacity;

- Introducing a dispute resolution procedure (with respect to third party access) as a condition of exemption;
- Conducting a formal review of the exemption after, say, 10 years;
- Requirement to construct extra capacity should potential users request this on commercially viable terms.

Withdrawal of an exemption

2.51. In the initial views paper, the DTI and Ofgem explained the grounds for withdrawal of an exemption. These included bankruptcy of the terminal operator and breach of competition law.

2.52. In the final views paper, the DTI and Ofgem expanded upon grounds for exemption. These are now envisaged to include:

- Breach of exemption criteria
- Breach of competition law
- Bankruptcy
- Mergers / acquisition activity

2.53. We have explained above that work remains to be done before we can confirm that the requested exemption can be seen to enhance competition. We will also be seeking further information on the financing arrangements envisaged for the project.

Summary

2.54. We have explained Ofgem's initial view as to each of the criterion for exemption as addressed in the draft application made by QP/EM. In summary, we consider that the QP / EM submission does demonstrate that all of the five criteria in the Gas Directive should be met. However, given ExxonMobil's interest in other parts of the market, we will be seeking further information with respect to the effect on competition, and the proposed financing arrangements before coming to a final view.

3. Way forward

3.1. QP/EM have requested that Ofgem is able to come to a final view by the end of 2003, or shortly thereafter. Before moving to this view, we wish to seek respondents' views. In addition, before we come to a final view, and given the veto powers of the European Commission, the DTI and Ofgem will be discussing our proposed view with the European Commission. At this point, we expect to reach a view on the draft application by QP/EM by the end of January 2004.

Appendix 1 : QP / EM draft exemption application

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Europe Regulatory Advisor

ExxonMobil
Gas Marketing

27th November 2003
Kyran Hanks
Director Gas Trading
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Dear Sir,

Qatargas II LNG Supply Project : Proposed UK LNG Import Terminal "South Hook" Informal Application For Exemption From Regulated Third Party Access

ExxonMobil International Limited is writing on behalf of Qatar Petroleum and ExxonMobil Qatargas (II) Limited, an affiliate.

Qatar Petroleum and ExxonMobil Qatargas (II) Limited are the sponsors of the Qatargas II LNG project, a full chain project for the supply of LNG to the UK, and as part of that project propose to develop an LNG import terminal called South Hook at Milford Haven in Wales.

The sponsors require comfort that the South Hook terminal would be exempted from regulated third party access arrangements as described in Directive 2003/55/EC. Recognising that UK Law does not currently support a formal application for exemption, the sponsors have prepared an informal application, in public and confidential versions, for exemption in accordance with the requirements of Article 22 of that Directive.

In order to avoid undue delay or cost to the project the sponsors are seeking positive early assurances and guidance (from both UK regulators and the Commission), by the end of 2003 or shortly thereafter, on the likely availability of an exemption. The sponsors are therefore asking that you expedite the consultation process. The sponsors look forward to substantially building confidence that an appropriate form of exemption will be available to allow the South Hook terminal to be built for purposes of receiving Qatargas II LNG into the UK.

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The sponsors will of course continue to be available to discuss with you and/or make such further submissions as may be reasonably be required.

Yours sincerely,

Ian Trickle
Europe Regulatory Advisor

cc Sue Harrison (Department of Trade and Industry)