

**Application by Dragon LNG Limited under
section 19C of the Gas Act 1986 for an
exemption from section 19D of the Gas Act
1986**

Ofgem Initial views

November 2004 264/04

Summary

The new EU Gas and Electricity Directives¹ introduce, amongst other things, a regulated third party access (RTPA) regime 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.

On 28 October 2004, Dragon LNG Limited (“Dragon”), currently a wholly owned subsidiary of Petroplus Tankstorage International B.V. (“Petroplus”), wrote to Ofgem requesting an exemption under Section 19C(2) of the Gas Act 1986 from the application of Section 19D of the Gas Act to the entire proposed capacity of its LNG import facility at Milford Haven. It is intended that the equity of Dragon will be jointly owned by Petroplus, and the throughputters BG Group and Petronas.

In its application, Dragon explains that its application demonstrates that the Dragon LNG import facility satisfies the criteria set out in Section 19C of the Gas Act 1986 for exemption, as well as the complementary tests set by Ofgem and the Department of Trade and Industry (DTI).

Ofgem’s preliminary view is that Dragon’s application is likely to meet all the criteria for exemption and, as such, this project could be expected to have an overall positive impact on competition and security and diversity of supply for the UK. Therefore, Ofgem’s initial view is that it would be appropriate to grant exemption.

¹ Directive 2003/55/EC of the European Parliament and of the Council concerning common rules for the internal market in electricity and repealing Directive 96/92/EC; and Directive 2003/54/EC of the European Parliament and of the Council concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC.

Table of contents

| | |
|--|-----------|
| Summary | 1 |
| 1. Introduction..... | 3 |
| Background..... | 3 |
| Views invited | 7 |
| Way forward | 7 |
| 2. Dragon LNG Limited exemption application | 9 |
| 3. Way forward..... | 20 |
| Appendix 1 Draft exemption order | 21 |

1. Introduction

Background

The EU Gas and Electricity Directives

- 1.1. The new EU Gas and Electricity Directives² introduce, amongst other things, an RTPA regime for interconnectors and LNG import terminals. The Directives allow exemption from RTPA by the relevant regulatory authorities, subject to veto by the European Commission. With respect to LNG import terminals, the new EU Gas Directive was transposed into GB law with the coming into force of the Gas (Third Party Access) Regulations 2004 on 26 August 2004. Ofgem therefore now has formal powers to grant exemption from the RTPA requirements for LNG import facilities, as set out in sections 19C and 19D of the Gas Act 1986.
- 1.2. The Directives set down criteria that have to be met in order to justify such an exemption being granted. The criteria contained in 19C(7) of the Gas Act 1986 relating to an exemption for an LNG import facility are:
 - (a) the facility or (as the case may be) the significant increase in its capacity will promote security of supply;
 - (b) the level of risk is such that the investment to construct the facility or (as the case may be) to modify the facility to provide for a significant increase in its capacity would not be or would not have been made without the exemption;
 - (c) the facility is or is to be owned by a person other than the gas transporter who operates or will operate the pipeline system connected or to be connected to the facility;

² Directive 2003/55/EC of the European Parliament and of the Council concerning common rules for the internal market in electricity and repealing Directive 96/92/EC; and Directive 2003/54/EC of the European Parliament and of the Council concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC.

- (d) charges will be levied on users of the facility or (as the case may be) the increase in its capacity;
- (e) the exemption will not be detrimental to competition, the operation of an economically efficient gas market or the efficient functioning of the pipeline system connected or to be connected to the facility; and
- (f) the Commission of the European Communities is or will be content with the exemption.

1.3. It should be noted that it is against these exemption requirements that Ofgem will assess any application for exemption. Whilst there may appear to be some minor differences between the criteria in the Gas Act 1986 and those contained in the new Gas Directive, Ofgem does not consider that there are any material differences between the two sets of criteria.

DTI/Ofgem exemption policy

1.4. In June 2003, the Department of Trade and Industry (DTI) and Ofgem issued a joint consultation document concerning new regulations to apply to LNG facilities and interconnectors.³ This document set out the initial views of the DTI/Ofgem regarding the regulatory regime for interconnectors and LNG facilities. In addition to a quantitative competition analysis, DTI/Ofgem identified three areas that would be minimum requirements for an exempt regime:

- ◆ effective capacity allocation in terms of an initial offer of capacity to market (though under specific circumstances this condition might be loosened);
- ◆ effective mechanisms to ensure that capacity is not hoarded i.e. Use It or Lose It (UIOLI) arrangements; and

³ 'LNG facilities and interconnectors, EU legislation and regulatory regime, DTI/Ofgem initial views', DTI/Ofgem, June 2003.

- ◆ information provision requirements relating both to the regulator and potentially also to market.

1.5. In November 2003, the DTI and Ofgem issued final views in relation to the new Directives and the resulting regulatory regime.⁴ By and large, the final views document confirmed, and clarified, the position set out in the initial views document. DTI and Ofgem expanded upon grounds for withdrawal of an exemption:

- ◆ breach of exemption criteria;
- ◆ breach of competition law;
- ◆ bankruptcy; or
- ◆ mergers / acquisition activity.

1.6. At the time, there were several potential projects that were moving to financial close prior to the Directives becoming transposed into GB law. Project developers requested early guidance as to whether they could expect their particular project to be exempt from RTPA. Ofgem said that while it would be prepared to give such guidance, any guidance 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. Ofgem indicated that while we would aim to ensure, as far as possible, that any potential guidance that is issued gave comfort as to the likely regulatory treatment of particular infrastructure, any such guidance issued would also be constrained to a significant extent by necessary legal caveats.

1.7. Ofgem received draft applications for exemption in respect of three projects. In each case, Ofgem consulted upon, and issued guidance to, each project. The first application was from Gastransport Services (GTS) for the proposed

⁴ 'LNG facilities and interconnectors, EU legislation and regulatory regime, DTI/Ofgem final views,' DTI/Ofgem, November 2003.

Balgzand Bacton pipeline project (BBL).⁵ The second application was received from Qatar Petroleum and ExxonMobil for the proposed South Hook LNG import terminal at Milford Haven in Wales.⁶ The third application was received from Dragon for the proposed LNG import terminal, also at Milford Haven.⁷

- 1.8. In each case, Ofgem expressed the view that the application for exemption would be likely to meet each of the exemption criteria set out in the relevant EU legislation. In these documents, Ofgem stated that once legislative authority was granted to Ofgem in respect of the ability to give exemptions to LNG facilities from the RTPA requirements, Ofgem would expect to undertake a formal consultation process in respect of formal applications it received for exemption.
- 1.9. In each case, Ofgem's views were submitted to the European Commission who indicated general support for Ofgem's position.

Formal application by Dragon LNG Limited

- 1.10. On 28 October 2004, Dragon LNG Limited ("Dragon"), currently a wholly owned subsidiary of Petroplus Tankstorage International B.V. ("Petroplus"), wrote to Ofgem requesting an exemption under Section 19C(2) of the Gas Act 1986 from the application of Section 19D of the Gas Act to the entire proposed capacity of its LNG import facility at Milford Haven. It is intended that the equity of Dragon will be jointly owned by Petroplus, and the throughputters BG Group and Petronas. The public version of Dragon's application for exemption can be found on the Ofgem website.⁸

⁵ 'Gastransport Services, Draft application for an exemption for the Balgzand Bacton Pipeline project (BBL), Final views', Ofgem, December 2003.

⁶ 'Qatar Petroleum and ExxonMobil, Draft Gas Directive Exemption Application for an LNG Terminal at Milford Haven, Final views', Ofgem, February 2004.

⁷ 'Dragon LNG Ltd, Draft application for an exemption for the Milford Haven LNG import terminal, Final views', Ofgem, June 2004.

⁸ www.ofgem.gov.uk, under "Europe" area of work.

Views invited

- 1.11. This document presents Ofgem's initial views on Dragon's formal exemption application. Ofgem would welcome views on the initial views contained in this document and on the draft exemption order contained in Appendix 1 to be received by close of business on 10 December 2004. All responses will normally be published on Ofgem's website and held in the Research and Information Centre. However, if respondents do not wish their response to be made public then they should clearly mark their response as confidential. Ofgem prefers to receive responses in an electronic form so they can be placed easily on the Ofgem website.
- 1.12. Responses should be addressed to:
- Steve Smith
Managing Director, Markets
Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE
- 1.13. Electronic responses should be sent to adam.higginson@ofgem.gov.uk
- 1.14. If you wish to discuss any aspect of this paper, Adam Higginson (telephone 020 7901 7432) would be pleased to help.

Way forward

- 1.15. Ofgem will consider responses received to this formal consultation in making a decision on whether to grant an exemption to Dragon from the application of section 19D of the Gas Act 1986 to its proposed LNG import facility at Milford Haven. As with the other applications, Ofgem's decision will include a conclusions document that Ofgem would expect to issue in December 2004.

1.16. Ofgem has recently clarified the process by which an exemption decision should be notified to the European Commission. If Ofgem decides that the exemption criteria have been met then the Authority will grant the exemption. Ofgem will then submit its exemption decision to the European Commission for it to make its decision as to whether Ofgem's decision should be withdrawn or amended. The European Commission has two months in which it can veto a decision by the relevant authority in a Member State to grant an exemption, or request that the regulatory authority amend its decision.⁹

⁹ This two month period may be extended by one additional month where additional information is sought by the Commission.

2. Dragon LNG Limited exemption application

- 2.1. On 17 March 2004, Dragon submitted a draft application to Ofgem which is available on the Ofgem website. The draft application requested early informal non-binding guidance as to the likely regulatory treatment of the import terminal project pending new legislation being introduced to implement, in part, the new Gas Directive. On 1 April 2004, Ofgem published initial views on Dragon's draft application requesting respondents' views. Having considered respondents' views, on 23 June 2004, Ofgem published final views on Dragon's draft application.
- 2.2. On 28 October 2004, Ofgem received from Dragon a formal application under section 19C(2) of the Gas Act 1986 for exemption from RTPA for the proposed Dragon LNG import terminal at Milford Haven in Wales. Dragon's formal application for exemption can be found on the Ofgem website. The exemption requested applies to:
- ◆ the initial capacity of six billion cubic meters (bcm) per year for a duration of 20 years; and
 - ◆ the expansion capacity of up to six bcm per year to be constructed in one or more phases for a duration of 20 years for each phase of expansion capacity.
- 2.3. Dragon's formal application updated information previously provided in their informal application where relevant.
- 2.4. This chapter summarises Ofgem's views on Dragon's draft application for exemption against the relevant criteria. This chapter also provides Ofgem's initial views on Dragon's formal application for exemption.

(a) the facility or (as the case may be) the significant increase in its capacity will promote security of supply

Ofgem's view on the draft application

- 2.5. Ofgem considered that gas in a new location could be expected to enhance security of supply, as could the fact that this gas would be from a new source.

Ofgem's initial view on the formal application

- 2.6. Ofgem considers that Dragon's formal application has not changed from its draft application in respect to this requirement. Therefore, Ofgem remains of the view that the Dragon LNG import facility would be likely to enhance security of supply and that this requirement is therefore likely to be met.

(b) the level of risk is such that the investment to construct the facility or (as the case may be) to modify the facility to provide for a significant increase in its capacity would not be or would not have been made without the exemption

Ofgem's view on the draft application

- 2.7. Ofgem considered that it is difficult to see how the risks associated with this project can be mitigated by anything other than some form of long-term contractual support. Therefore, in that context, on the basis of the analysis provided by Dragon and its financial advisors, and Ofgem's preferred approach to entrepreneurial projects presented in Ofgem's joint consultation with the DTI, Ofgem's initial view was that the level of risk attached to the import terminal merits exemption.

Ofgem's initial view on the formal application

- 2.8. Ofgem notes that Dragon explains that the project will not proceed unless the exemption is granted due to the degree of risk involved in pursuing this project and the extent of the investment and financing needed both for this project and for the other parts of the LNG chain.

2.9. Ofgem considers that Dragon's formal application has not changed from its draft application in respect to this requirement. Therefore, Ofgem remains of the view that this requirement is likely to be met.

(c) the facility is or is to be owned by a person other than the gas transporter who operates or will operate the pipeline system connected or to be connected to the facility

Ofgem's view on the draft application

2.10. Ofgem explained that it was clear that the Dragon LNG import facility would be fully separate from Transco, the system operator of the transportation system to which the facility is to be connected. On that basis, Ofgem expected this criterion to be satisfied.

Ofgem's initial view on the formal application

2.11. Ofgem considers that Dragon's formal application has not changed from its draft application in respect to this requirement. Therefore, Ofgem remains of the view that this requirement is likely to be met.

(d) charges will be levied on users of the facility or (as the case may be) the increase in its capacity

Ofgem's view on the draft application

2.12. Ofgem considered that tariffs should be made publicly available. Ofgem considered that this requirement is likely to be met.

Ofgem's initial view on the formal application

2.13. Ofgem's initial preference was that LNG import facility operators make information on tariffs publicly available. Ofgem now considers that Dragon should not be required to publish its tariffs. Ofgem considers that there should, where possible, be equivalence in the information required of LNG facility operators to that generally required of similar activities in relevant gas and electricity markets. Therefore, Ofgem does not consider LNG import

facility operators should be required to make this information publicly available.

- 2.14. It should be noted that under the requirements of the exemption order Dragon could be required to provide Ofgem with such information as tariffs. Therefore, Ofgem will have access to the necessary information to investigate any disputes raised by market participants over tariffs should such disputes arise. It should also be noted that, in certain circumstances, Ofgem has statutory powers to publish or disclose information.
- 2.15. Ofgem considers that on the basis that the importation shippers will be charged an annual charge for the use of capacity at the Dragon LNG import facility, this exemption requirement is likely to be met.

(e) the exemption will not be detrimental to competition, the operation of an economically efficient gas market or the efficient functioning of the pipeline system connected or to be connected to the facility

Ofgem's view on the draft application

- 2.16. In the draft application Dragon explained that following an open season and negotiations between Petroplus and a number of interested parties, capacity in the LNG import facility was to be sold to two throughputters, BG Group and Petronas. Dragon explained that BG had purchased 50 per cent of the initial six bcm per year capacity at the LNG import facility with an option to purchase additional capacity in the proposed expansion. In addition, BG had invested in the Dragon LNG import facility as an equity holder by purchasing 50 per cent of the shares in Dragon. Dragon further explained that negotiations are ongoing between Dragon and Petronas regarding a throughput agreement for the other 50 per cent of the initial six bcm per year capacity, an option to purchase additional capacity in an expansion and 30 per cent of the equity in Dragon.
- 2.17. Ofgem considered that in terms of upstream and wholesale market considerations, as a new entrant to both market sectors, the presence of Petronas could be expected to enhance competition in both. As for the

downstream market, Petronas has no existing interests and this situation is not expected to change. However, Ofgem considered that Petronas' involvement as a new entrant in the upstream and wholesale markets can be expected to be good for downstream competition.

- 2.18. Ofgem explained that BG's share of the upstream market is eight per cent and the addition of gas volumes from the import terminal are not expected to change this figure to the extent that it would raise any competition concerns. Ofgem considered that this remains the case even after having taken into account the expansion options available to BG (and Petronas).
- 2.19. At the wholesale level, Ofgem recognised that gas brought through the terminal will be sold at the NBP, ie. a liquid traded market. Moreover, Ofgem welcomed Dragon's advice that neither BG nor Petronas will impose any resale or destination restrictions on the gas sold, and that this should allow the further trading of the gas.
- 2.20. In terms of the downstream market, Ofgem explained that BG's percentage share – even taking into account BG's contracts to supply power generators - is in single figures and this would remain the case, other things being equal, after including future gas flows from the import terminal. As such, Ofgem considered that the Dragon LNG import terminal will not have a negative effect on downstream competition in terms of a change in BG's position.
- 2.21. Therefore, Ofgem was of the view that the project, when considered in isolation, is likely to meet this criterion. In particular, as the project would enhance the overall level of gas supply, this should increase competition to the benefit for customers, a benefit that would otherwise not have existed.
- 2.22. Ofgem remained committed to the requirement of robust UIOLI services so that unused capacity is made available to the market, and to ensure capacity is not hoarded. Ofgem was reassured that Dragon would not prevent unused capacity being made available to the market and in the event there is capacity available which the throughputters do not intend to use, Dragon will

advertise this capacity to the market in a transparent and non-discriminatory way.

Ofgem's initial view on the formal application

- 2.23. In the formal application Dragon explains that Dragon, BG and Petronas are currently finalising the throughput agreements and other binding agreements.
- 2.24. One aspect of the formal application that has changed from the draft application is that Centrica has concluded a purchase contract for gas with Petronas for three bcm of gas per year after an initial ramp up period. This would be delivered through the three bcm per year of capacity that has been bought by Petronas in the initial phase at the Dragon LNG import facility. Ofgem's initial view, which we would welcome responses on, is that there is not anything about this contractual arrangement for the gas supply that would lead it to change its previous conclusion that the exemption of the Dragon LNG import facility would not be detrimental to competition.
- 2.25. Based on information that has been received from Centrica, the contractual arrangement has the following features:
- ◆ the contract duration is 15 years;
 - ◆ entry capacity into the UK will be purchased by Petronas, who have already participated in Transco's long term capacity auctions;
 - ◆ the purchase contract has no resale or destination clauses thereby allowing further trading of the gas;
 - ◆ the contract, while not being struck at the NBP, is priced relative to the NBP (i.e. at UK gas market-related prices);
 - ◆ Centrica will have no incentive to withhold gas under this contract given that it is 100 per cent take or pay.

2.26. Centrica currently supplies around 33 per cent of the GB gas retail market.¹⁰ However, Centrica's purchase contract with Petronas is not expected to impact on competition in the retail market given that:

- ◆ Ofgem is not aware of evidence to suggest that new entrants and current market participants will not be able to compete within the retail market because of insufficient access to future gas supplies;
- ◆ the GB market is dynamic enough to respond to changes in demand and supply;
- ◆ Ofgem considers that its existing powers under UK and European competition legislation should provide sufficient protection against any future abuse within the GB gas market relating to gas trading. For example, Ofgem has concurrent powers with the Office of Fair Trading (OFT) to investigate and fine companies under the Competition Act 1998 if abuse is found to have occurred.

2.27. Given the above considerations, Ofgem considers that these supply deals are not directly relevant to the exemption proposed at the Dragon LNG import terminal. Ofgem therefore considers that its initial view that the project would be beneficial for upstream gas competition and would have no material effect on downstream competition is still appropriate. However, Ofgem would welcome views from respondents on this initial view.

2.28. It should be noted that Ofgem's views as to whether the exemption will not be detrimental to competition continues to be dependent on Dragon providing facilities for secondary trading and anti-hoarding mechanisms (i.e. UIOLI arrangements). Ofgem has not specifically approved the anti-hoarding measures that will be put in place by Dragon. However, should the arrangements put in place by Dragon result in primary capacity not being utilised, this could constitute grounds for reviewing the exemption, in particular on the grounds that the exemption from section 19D is operating in

¹⁰ Source: Centrica.

such a manner that is detrimental to competition or the operation of an economically efficient gas market. In Ofgem's view, at the very least Dragon will need to demonstrate that there is a transparent mechanism that allows spare capacity to be made available to market and that unused capacity can be obtained in a transparent market-based manner by third parties so as to maximise the use of the LNG import facility concerned.

- 2.29. Having taken into consideration the changes from the draft application, Ofgem remains of the view that this requirement is likely to be met.

(f) the Commission of the European Communities is or will be content with the exemption

- 2.30. Ofgem considers that its initial view that the project would be beneficial for upstream gas competition and would have no material effect on downstream competition is still appropriate. Ofgem considers that this project could be expected to have an overall positive impact on competition. Ofgem therefore expects that the European Commission should be content with the exemption.

The draft exemption order

Withdrawal/amendment of an exemption by the European Commission

- 2.31. As set out previously, Ofgem has recently clarified the process by which an exemption decision should be notified to the European Commission. To reflect this clarification, Ofgem has made amendments to the draft exemption order set out in Appendix 1 to this document as compared with the draft exemption orders that were consulted on as part of the formal application for exemption in respect of the South Hook LNG import terminal¹¹ and the Isle of Grain import terminal¹².

¹¹ 'Consultation on an application by South Hook LNG Terminal Company Ltd (SHTCL) (owned by Qatar Petroleum and ExxonMobil) under section 19C of the Gas Act 1986 for an exemption from section 19D of the Gas Act 1986', Ofgem, October 2004.

¹² 'Application by Grain LNG Ltd under section 19C of the Gas Act 1986 for an exemption from section

2.32. To ensure consistency, Ofgem intends to reflect these amendments in any exemption orders that may be granted under section 19C, including the draft exemption orders for the South Hook LNG and Isle of Grain LNG import facility.

Withdrawal of an exemption

2.33. In all the documents published by the DTI and Ofgem on the award of an exemption from RTPA, Ofgem and the DTI have highlighted that there will remain grounds for amendment and, in extremis, revocation of an exemption. These grounds are:

- (a) there is a material decrease in the degree to which the requirements of subsections 19C(7)(a), (c), (d) or (e) of the Gas Act 1986 are met with respect to the facility as the result of an action or omission of the facility owner, facility operator, or throughputter;
- (b) the facility owner is declared bankrupt;
- (c) the facility owner is found to be in breach of the Competition Act 1998; or
- (d) there is merger or acquisition activity in relation to, or by facility owner, that is detrimental to competition.

2.34. Condition (b) has since been clarified as the following grounds:

- ◆ the facility owner has a receiver (which expression shall include an administrative receiver within the meaning of section 251 of the Insolvency Act 1986) of the whole or any material part of its assets or undertaking appointed; and
- ◆ the facility owner has an administration order under section 8 of the Insolvency Act 1986 made in relation to it.

19D of the Gas Act 1986, Ofgem, October 2004.

- 2.35. It is important to bear in mind that the analysis of the exemption request has been, and the subsequent review by the European Commission, will be undertaken on the basis of the facts put to Ofgem. Significant changes in this underlying data could represent grounds for review of the exemption.
- 2.36. That is not to say that an exemption will automatically be revoked should there be material changes in the nature of the Dragon LNG import terminal project. Rather, that it would be open to Ofgem to review the appropriateness of the exemption remaining in place in the event that any of the specified circumstances arise.
- 2.37. For the avoidance of doubt, in the event that any of the circumstances occur which may give rise to revocation of an exemption Ofgem would not automatically move to revoke the exemption by giving four month notice that the exemption order is to be revoked. First, Ofgem would enter into discussions with the party or parties involved to establish whether any of the conditions have not been met. Secondly, in the absence of a need to act urgently, Ofgem would give the party or parties involved the opportunity in reasonable timescales to remedy the circumstances which have caused the grounds for revocation to arise. In the event that in reasonable timescales the party or parties involved have not remedied the circumstances which have caused the grounds for revocation to arise, Ofgem would at this stage consider giving four months notice that the exemption order is to be revoked.

Transfer of an exemption

- 2.38. Ofgem has made a further amendment to the draft exemption order set out in Appendix 1 to this document as compared with the draft exemption orders that were consulted on previously. This is to allow for the transfer of an exemption to another facility owner and is dependent upon the written consent of the Authority. Again, Ofgem intends to reflect this amendment in any exemption orders that may be granted under section 19C.
- 2.39. As part of its application for exemption, Dragon has identified that there may be a transfer of ownership of the facility to a different legal entity, albeit with

the same ultimate company owners and in the same equity shares. Given this, Ofgem's initial view is that this consultation would be equally applicable to considerations for transferring an exemption to this new different legal entity should Dragon choose to structure its corporate affairs in this manner.

Summary

- 2.40. In summary, Ofgem's preliminary view is that all the five criteria discussed above seem likely to be met and, as such, this project could be expected to have an overall positive impact on competition and security and diversity of supply for the UK. Therefore, Ofgem's initial view is that it would be appropriate to grant exemption to the initial capacity of six bcm for a duration of 20 years and to the expansion capacity of up to six bcm per year for a duration of 20 years for each phase of expansion capacity from the date that each phase of the expansion capacity commences commercial operation.
- 2.41. For the avoidance of doubt, Ofgem's analysis has been carried out against the exemption criteria and is specific to the application for an exemption that Ofgem is considering. Any decision that Ofgem may make in relation to this application for an exemption does not preclude or impact in anyway on the operation of the Competition Act 1998 or the Enterprise Act 2002. Further, as the analysis contained in this document is in relation to a specific situation, the analysis may or may not necessarily be relevant to a consideration of any related issues that may arise, for example under the Gas Act 1986, the Competition Act 1998 or the Enterprise Act 2002.

3. Way forward

- 3.1. Ofgem will carefully consider responses received to this consultation on Dragon's formal request for exemption to help inform Ofgem's final views which will be submitted to the European Commission. As mentioned previously, the European Commission has two months in which it can veto a decision by the relevant authority in a Member State to grant an exemption, or request that the regulatory authority amend the exemption.¹³ A draft exemption order for the Dragon LNG import facility is contained in Appendix 1.

¹³ This two month period may be extended by one additional month where additional information is sought by the Commission.

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Appendix 1 Draft exemption order

GAS ACT 1986

SECTION 19C

EXEMPTION

Pursuant to sub-section 19C(5) of the Gas Act 1986 (the Act), the Gas and Electricity Markets Authority hereby gives to Dragon LNG Limited¹⁴, as the owner of an LNG import facility, an exemption from the application of section 19D of the Act in respect to the LNG import facility located at Waterstone, Milford Haven, Pembrokeshire, SA7 31DR, subject to the attached Schedule.

Steve Smith

Authorised in that behalf by the

Gas and Electricity Markets Authority

Dated

¹⁴ Registered in England No04562711; Registered Office: Adelaide House, London Bridge, London EC4R 9HA.

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SCHEDULE

PERIOD, CONDITIONS, AND REVOCATION OF EXEMPTION

A. Interpretation and Definitions

In this exemption:

| | |
|---------------------|---|
| “the Authority” | means the Gas and Electricity Markets Authority established by section 1(1) of the Utilities Act 2000 |
| “the Act” | means the Gas Act 1986 as amended from time to time |
| “the facility” | means LNG import facility |
| “facility owner” | means Dragon LNG Terminal Company Ltd in its capacity as owner of the facility |
| “facility operator” | means Dragon LNG Terminal Company Ltd in its capacity as operator of the facility |
| “throughputter” | means any user of the facility |

B. Full description of the LNG import facility to which this exemption relates

The Dragon LNG import facility with:

- (a) an initial capacity of six billion cubic meters per year and;
- (b) an expanded capacity of up to six billion cubic meters per year, to be constructed in one or more phases.

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C. Period

Subject to section E below, and pursuant to section 19C(3)(a) of the Act, this exemption will cease to have effect:

- (a) in respect of the initial capacity of the facility, 20 years from the date that the facility commences commercial operation; and
- (b) in respect of the expansion capacity, 20 years for each phase of expansion capacity from the date that each phase of the expansion capacity commences commercial operation.

D. Conditions

Pursuant to sub-section 19C(3)(b) of the Act, this exemption is made subject to the following conditions:

1. That the material provided by the facility owner to the Authority in respect of this exemption is and remains accurate in all material respects.
2. The facility owner notifies the Authority within ten days of:
 - (a) the initial capacity of the facility commencing commercial operation; and
 - (b) each phase of the expansion capacity commencing commercial operation.
3. The facility owner furnishes the Authority in such manner and at such times as the Authority may reasonably require, with such information as the Authority may reasonably require, or as may be necessary, for the purpose of
 - (a) performing the functions assigned to it by or under the Act, the Utilities Act 2000, or the Energy Act 2004; or
 - (b) monitoring the operation of the exemption.
4. The facility owner complies with any direction given by the Authority (after the Authority has consulted the relevant gas transporter and, where relevant, the Health and Safety Executive) to supply to the relevant gas transporter such information as may be specified or described in the direction -

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- (a) at such times, in such form and such manner; and
- (b) in respect of such periods, as may be so specified or described.

Where the facility owner is prevented from complying with such a direction by a matter beyond its control, it shall not be treated as having contravened the condition specified in this paragraph.

In this condition:

| | |
|----------------------------|---|
| “information” | means information relating to the operation of the pipe-line system which is operated by a relevant gas transporter |
| “relevant gas transporter” | means any holder of a gas transporter licence under section 7 of the Act owning a transportation system within Great Britain to which the facility is connected or with whom the facility operator interfaces with as a system operator |

- 5. Should any of the grounds for revocation arise under section E of this exemption, the Authority may, with the consent of the facility owner, amend this exemption rather than revoke the exemption.
- 6. The Authority may, with the consent of the facility owner, amend this exemption where the Authority has been requested to amend the decision to grant this exemption by the European Commission (such request being made in accordance with Article 22(4) of Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003).
- 7. This exemption is transferable to another facility owner where the Authority has given its written consent to such a transfer. For the avoidance of doubt, all of the conditions contained in this exemption order continue unaffected in respect of any facility owner to whom this exemption order may be transferred.

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E. Revocation

Pursuant to sub-section 19C(4) of the Act, this exemption may be revoked in the following circumstances:

1. The Authority may revoke this exemption where the European Commission has requested (in accordance with Article 22(4) of Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003) that the Authority withdraw the decision to grant this exemption.
2. The Authority may revoke this exemption where the European Commission has requested (in accordance with Article 22(4) of Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003) the Authority amend the decision to grant this exemption and the facility owner does not agree (under paragraph D6 above) for this exemption to be amended in the manner so requested by the European Commission.
3. This exemption may also be revoked by the Authority by giving a notice of revocation to the facility owner not less than four months before the coming into force of the revocation in any of the following circumstances:
 - (a) where:
 - i. in the Authority's reasonable opinion there is a material change in the degree to which the requirements of sub-sections 19C(7)(a), (c), (d) or (e) of the Act are met with respect to the facility as the result of an action or omission of the facility owner, facility operator, or throughputter;
 - ii. the facility owner has a receiver (which expression shall include an administrative receiver within the meaning of section 251 of the Insolvency Act 1986) of the whole or any material part of its assets or undertaking appointed;
 - iii. the facility owner has an administration order under section 8 of the Insolvency Act 1986 made in relation to it;

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- iv. the facility owner is found to be in breach of the Competition Act 1998; or
 - v. there is merger or acquisition activity in relation to, or by the facility owner, that is detrimental to competition.
- (b) the facility owner has failed to comply with a request for information issued by the Authority under paragraph D3 above and the Authority has written to the facility owner stating that the request has not been complied with and giving the facility owner notice that if the request for information remains outstanding past the period specified in the notice, the exemption may be revoked; or
- (c) the facility owner has failed to comply with a direction issued by the Authority under paragraph D4 above and the Authority has written to the facility owner stating that the direction has not been complied with and giving the facility owner notice that if the direction remains outstanding past the period specified in the notice, the exemption may be revoked.