bbl company

Application document for an exemption from regulated third party access for the BBL pipeline project

(UK: in response to Schedule 2, paragraph IV, paragraph 3 of the Applications Regulations)

Contents

1. Application for an exemption for the BBL pipeline

Introduction

1.1. N.V. Nederlandse Gasunie - through its gas transport business unit, Gastransport Services ("GtS") (since July 2004, the transmission system operator has been legally unbundled and has been named Gas Transport Services) - initiated the development and construction of a gas pipeline, compressor stations and ancillary technical facilities for the transmission of gas between the Netherlands and the United Kingdom, connecting Balgzand and Bacton. The project is referred to as the Balgzand Bacton Line (BBL). A general partnership by the name of **BBL Company V.O.F.** (hereafter "BBL Company") has been established between Netherlands-based subsidiaries of N.V. Nederlandse Gasunie, E.ON Ruhrgas AG and Fluxys N.V. The object of BBL Company is the design, construction and operation - including the performance of transmission services - of the BBL.

1.2. The BBL project represents a very large investment, currently estimated at ca. 500 million EUR, which carries corresponding risk. To deal with this risk, the decision to build the BBL has been taken on the basis of long-term contracted capacity. Furthermore, it is essential to have certainty regarding the regulatory framework for the BBL, which is compatible in duration and character with the long-term transmission contracts that ultimately underpin the investment. The latter is also important because the BBL is an interconnecting pipeline between two EU member states involving multiple jurisdictions, thus increasing the "regulatory risk" associated with the project.

1.3. The assurances sought with respect to the regulatory framework for the BBL are consistent with the provisions of Article 22 of the EU Gas Directive (2003/55/EC). This article allows Member States to exempt certain new infrastructure from the provisions of articles 18, 19, 20 and 25 (2,3,4) under a number of conditions whilst at the same time informing the European Commission. The European Commission may subsequently decide on exemptions granted by national authorities.

1.4. Gastransport Services, as initiator of the project, sought comfort from the national authorities that the BBL project would be eligible for an exemption, once the EU Gas Directive was transposed into national law. The Ministry of Economic affairs in the Netherlands and Ofgem in the United Kingdom gave such comfort in letters dated 1 December 2003 and 24 November 2003 respectively and this comfort was notified to the European Commission. The Commission services subsequently approved the comfort from the national authorities in letters dated 30 January and 14 May 2004.

1.5. The comfort given by the national and European authorities proved an essential basis for the investment decision that was taken on 25 May 2004. Had the appropriate comfort not been forthcoming the decision to proceed with the project would not have been taken. BBL Company was subsequently established on 9 July 2004 to develop and operate the BBL pipeline on the basis that there was sufficient comfort from national and European authorities that a final exemption according to article 22 of the EU gas Directive as implemented in national legislation would be obtained in due course.

1.6. Based on this comfort for an exemption from the relevant authorities and based on the exchange of information that has taken place with the authorities leading up to the comfort letters, BBL Company is now seeking a formal exemption for the BBL pipeline project.

1.7. The BBL project was shown to comply with the conditions ex. Article 22 of the EU Gas Directive in the early guidance or “comfort” procedure for an exemption. This formal application for an exemption therefore revisits the conditions and recalls the evidence that GtS brought forward in the course of the comfort procedure. It also includes any new information compared to the original draft request that may have come available. All supporting documentation, including the documents submitted by GtS to the relevant authorities in the early guidance procedure, is attached to this application in separate (confidential) annexes.

Formal application for an exemption

1.8. BBL Company hereby applies for an exemption based on article 22 of the EU Gas Directive (2003/55/EC) as implemented in the Dutch and UK legislative frameworks. In the Netherlands, the application is made under the new article 18h of the Dutch Gas Act (Wet van 22 juni 2000 inhoudende regels omtrent het transport en de levering van gas (Gaswet), gewijzigd door de Wijziging van de Gaswet ter uitvoering van richtlijn nr. 2003/55/EG (PbEG L176)). BBL Company applies for an exemption from the following paragraphs in the Gas Act: paragraph 2.2. (Articles 12, 13) 2.3 (Articles 14, 15, 16, 17, 17a, 17b), and 2.5 (Articles 19 and 20).

1.9. In the UK, BBL Company bases this application on the provisions of sections 149 and 150 of the Energy Act 2004 which amend the Gas Act 1986 by introducing section 7ZA into the Gas Act 1986. This application is in response to Schedule 2, Paragraph IV, paragraph 3 of the Applications Regulations and seeks to make an application for an Interconnector License where the following standard conditions are requested not to have effect, thus introducing an exempt regime as provided for under Condition 10:

- Condition 8: Charging methodology to apply to third party access to the licensee’s interconnector and
- Condition 9: Requirement to offer terms for access to the licensee’s interconnector.

1.10. The application for an exemption in the Netherlands and an exempt Interconnector License in the United Kingdom are referred to in this application document as **"the exemption"**.

Scope of the exemption requested in the UK and The Netherlands

1.11. The exemption is requested for the full capacity of the pipeline, based on the initial contracts concluded in the course of the open season and for the total duration of the initial contracts. At the time of this application the initial contracts are estimated to start in Q4 2006 (but no later than 1 December 2007) and 1 December 2007 respectively and the exemption would in that case be requested from Q4 2006 up to 1 December 2022. The term "initial contracts" refers to the commitments made by shippers for the booking of long term transmission capacity in the BBL pipeline on the basis of the open season and thus before the BBL investment decision had been taken. The BBL Company wishes to execute the initial transmission contracts that underpin the investment in the BBL, in an unfettered manner. These initial contracts defined the capacity and technical specifications of the BBL.

1.12. The initial contracts have different durations, as well as different starting dates in order to match shippers' needs. In order to create a level playing field for all shippers in the BBL, an exemption for said period is considered appropriate. This duration is requested on the basis that unused capacity will be made available to the market (through a variety of measures preventing the hoarding of capacity that are explained later in this application) and that freed-up capacity due to the expiration of initial contracts will be offered to the market in a non-discriminatory and transparent way, via an open season or other suitable process. It is proposed that capacity is offered to the market in a way, which is consistent with the conditions in the initial contracts.

1.13. Furthermore, the exemption is requested to apply to the whole of the BBL pipeline capacity, and thus including any (interruptible or other) reverse flow services offered by BBL Company.

1.14. Whilst the capacity and technical specifications of the BBL have been determined by the contracted long term capacity rights, some capacity may be available between first gas and the start of other initial contracts. Furthermore, subject to the technical aspects of the realisation of the BBL, a limited amount of capacity may be available over and above the contracted long-term capacities. BBL Company will offer any such capacity (insofar there is sufficient market interest) to the market under suitable terms. The terms and conditions will need to ensure that initial contracts are not prejudiced. BBL Company would therefore also expect the exemption to apply to the contracts for the sale of any such "spare" transport capacity.

1.15. The outcome of the open season means that the physical flow direction of the BBL will be from the Continent to the UK. However, the BBL transmission contracts explicitly allow for contractual counter flows (on the basis of the secondary capacity market) and BBL Company envisages offering reverse flow services on an interruptible and non-discriminatory basis in the primary market. The terms and conditions for reverse flow interruptible services are currently under consideration, and it is the view of BBL Company that these terms and conditions should – insofar appropriate and taking into account the different nature of interruptible services as well as the duration of services - reflect the terms and conditions of the initial contracts that ultimately underpin the investment. BBL Company therefore expects the exemption to apply for reverse flow contracts as well. In this way the secondary market - which is by definition unregulated - will not be aversely affected.

2. Meeting the conditions for an exemption

2.1. The BBL project was shown to comply with the conditions ex. Article 22 of the EU Gas Directive in the early guidance or "comfort" procedure for an exemption. This application for an exemption revisits the conditions and recalls the evidence that GtS brought forward in the course of the comfort procedure.

2.2. The conditions that the EU, Dutch and UK legislation attach to the eligibility for an exemption are[1]:

a) The investment must enhance competition in gas supply and enhance security of supply
b) The level of risk attached to the pipeline is such that the investment would not take place unless an exemption is granted.
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.
d) Charges are levied on users of that infrastructure.
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.

2.3. In the course of the early guidance procedure in the UK and the Netherlands a vast amount of information was submitted to the authorities. A comprehensive list of documents submitted is given below and the accompanying correspondence is attached in ANNEX E.

Date	**Subject**	**Confidential**
15 April 2003	draft letter from GtS regarding comfort BBL	confidential
30 April 2003	e-mail to DTe regarding regulatory framework in the UK	confidential
08 May 2003	letter from DTe regarding questions	confidential
13 May 2003	letter to DTe regarding questions	confidential

[1] UK: reference is made to Condition 10 of the Licence Conditions and the relevant conditions mentioned there:

a. Condition 10(2)(a) of the Licence Conditions and Para 3(b)(i) of Part IV of Schedule 2 under Regulation 6 of the Applications Regulations.
b. Condition 10(2)(b) of the Licence Conditions and Para 3(b)(ii) of Part IV of Schedule 2 under Regulation 6 of the Applications Regulations.
c. Condition 10(2)(c) of the Licence Conditions and Para 3(c)(i) of Part IV of Schedule 2 under Regulation 6 of the Applications Regulations.
d. Condition 10(2)(d) of the Licence Conditions and Para 3(c)(ii) of Part IV of Schedule 2 under Regulation 6 of the Applications Regulations.
e. Condition 10(2)(f) of the Licence Conditions and Para 3(b)(iiI) of Part IV of Schedule 2 under Regulation 6 of the Applications Regulations.

NL: reference is made to article 18h Gaswet and the corresponding conditions in paragraph 1 a, b, c, and e of article 18h.
EU Directive 2003/55/EC: the conditions correspond with article 22, paragraph 1 a, b, c, and e.

19 May2003	e-mail from DTe regarding additional questions	confidential
19 May 2003	e-mail to DTe answering additional questions	confidential
05 June 2003	letter to DTe regarding advice DTe	confidential
12 June 2003	comfort letter Ofgem	confidential
13 June 2003	comfort letter EZ including advice DTe	confidential
15 August 2003	e-mail from DTe, regarding questions about the BBL project	confidential
17 September 2003	letters to EZ, DTe, Ofgem and EC regarding draft application for an exemption	
22 September 2003	consultation document Ofgem/ DTe	
22 September 2003	e-mail from the EC regarding Draft application for an exemption	confidential
22 September 2003	e-mail to Ofgem, DTI regarding confidential annexes to draft application	confidential
22 September 2003	e-mail to DTe, EZ regarding confidential annexes to draft application	confidential
24 September 2003	e-mail from the EC regarding questions	confidential
13 October 2003	e-mail to Ofgem, EZ, DTI regarding questions from the European Commission	confidential
07 November 2003	e-mail from DTe regarding risk analysis	confidential
13 November 2003	e-mail to EZ, DTI, DTe, Ofgem, regarding Press release cooperation with Fluxys	confidential
18 November 2003	letter with answers to EC questions	confidential
21 November 2003	e-mail to Ofgem regarding duration of exemption	confidential
21 November 2003	e-mail to DTe, EZ, regarding use it or lose it	confidential
21 November 2003	letter to DTe with additional information regarding risk assessment	confidential
24 November 2003	comfort letter from Ofgem	
1 December 2003	comfort letter from EZ and DTe advice	confidential
1 December 2003	final views document Ofgem	confidential
19 December 2003	Supplementary Questions from the EU Commission to Ofgem and Minez/DTe	confidential
22 December 2003	GtS answers to the Commission Questions dated 19 December 2003	confidential
23 December 2003	ABN AMRO letter to GTS regarding risk assessment	confidential
23 January 2004	Letter regarding shippers, risk assessment and Business plan	confidential
23 January 2004	E-mail regarding business plan	confidential
30 January 2004	Letter from the EC	confidential
6 February 2004	GtS comments on EC letter	confidential

5 March 2004	GtS comments on comfort letter issues raised through Ofgem	confidential
8 March 2004	GtS letter clarifying duration of exemption	confidential
11 March 2004	E-mail explaining confidentiality of letters dated 8 March	
18 March 2004	E-mail with conclusions from the meeting with DG COMP	confidential
18 March 2004	BBL transmission contracts	confidential
18 March 2004	Copies of presentations to DG COMP and spreadsheets with tariff methodology	confidential
18 March 2004	DTI's conclusions from meeting with Commission	confidential
19 March 2004	Further information on spreadsheets with calculations	confidential
19 March 2004	Question from Commission on tariff methodology	confidential
22 March 2004	Explanation of open season and tariff methodology	confidential
25 March 2004	Further questions from Commission (DG COMP)	confidential
29 March 2004	Answers to DG COMP questions	confidential
7 April, 2004	Question from DG TREN relating to a shipping contract	confidential
7 April 2004	Answer to DG TREN	confidential
13 April 2004	Letter regarding status of initial contracts	confidential
29 April 2004	E-mail regarding status of initial contracts	confidential
29 April 2004	E-mail regarding status of initial contracts	confidential
14 May 2004	Letter from EC	confidential

A. Meeting condition a; Competition and Security of Supply

Improved Competition in the gas market

2.4. In the early guidance procedure, it was indicated that the European Commission has identified that one of the missing links in the main gas infrastructure in Europe is an interconnection between the Netherlands and the UK[2]. The BBL provides that missing link and assists in meeting the need for gas in the UK. In the future, it may even play an important role in transporting Russian gas volumes to the UK.

2.5. In this procedure the competitiveness of the UK gas market was stressed as an important issue by the relevant authorities. The BBL project will - through the availability of an alternative route to the UK gas market - have a favourable effect on the operation of the market both at the European level as well as in the UK.

2.6. In order to give a meaningful insight into the effects of the BBL on competition in the UK market, an independent study by ADL was commissioned. An independent consultant was commissioned because the effect of the BBL is not a matter for the developer of that pipeline to assess in detail. The main argument here was that infrastructure owners could not rightfully ask their contractual counterparts to whom they are selling their gas, or from whom they bought it. Consequently, in case of regulatory or legal concerns with respect to the state of competition in either of the gas markets connected by the BBL it would not seem appropriate to remedy these concerns by imposing conditions on the owner or operator of that infrastructure.

2.7. Today, BBL Company also believes it is not in the position to assess the competition effects itself and has commissioned an update of the competition study for this formal application document. The study and update thereof by ADL were carried out using only publicly available data.

2.8. The updated report by ADL is attached to this application. The main conclusions are inserted here:

- The study shows that there is a low level of market concentration in the upstream side of the market currently, which is expected to diminish especially if BBL is built as gas would be purchased from other producers and would flow through other (new) infrastructure.

[2] As part of the Trans European Energy Networks (TEN), the European Commission has identified an interconnector between the United Kingdom and the Netherlands as a priority. Prioritisation under the TEN is based partly on the positive effect of the various projects on the operation of the internal gas market.

- There is easy entry and exit to the UK market as exemplified by the number of new entrants.
- In the downstream market, there is a relatively low level of market concentration in gas sold to power generators. Market concentration has risen in the industrial and commercial sector, however, the significant changes in market share and the very aggressive marketing in the recent contracting round give no reason to think that there is weak competition.
- In the residential sector British Gas continues to hold a dominant market position, but does not appear to be using this to engage in predatory pricing nor is it earning excess profits.
- There is significant headroom to attract new entrants and to maintain the interest of the current players in expanding their customer base, as recent price changes appear to have increased profit margins substantially.
- In terms of its effect on the UK gas market, the BBL will not increase the level of market concentration in any segment of the market, upstream or downstream. At worst, it has no effect on concentration, and at best, by creating additional capacity it can create additional competition.

2.9. Apart from the effect of the BBL on the operation of the internal market for gas as a commodity, it was also noted in the early guidance process that the BBL would have a positive impact on the operation of the internal gas transport market. At present, apart from the Interconnector, there are no direct links between the United Kingdom and the Continent. The BBL offers an alternative transport route to the existing Interconnector. Moreover, this and other infrastructure projects provide alternative sources of gas to the UK (Figure 1). The BBL will not be able to completely fill the projected gap between supply and demand on the UK gas market. Therefore, the BBL does not prohibit the development of other projects (and or sources of gas) to the UK gas market.

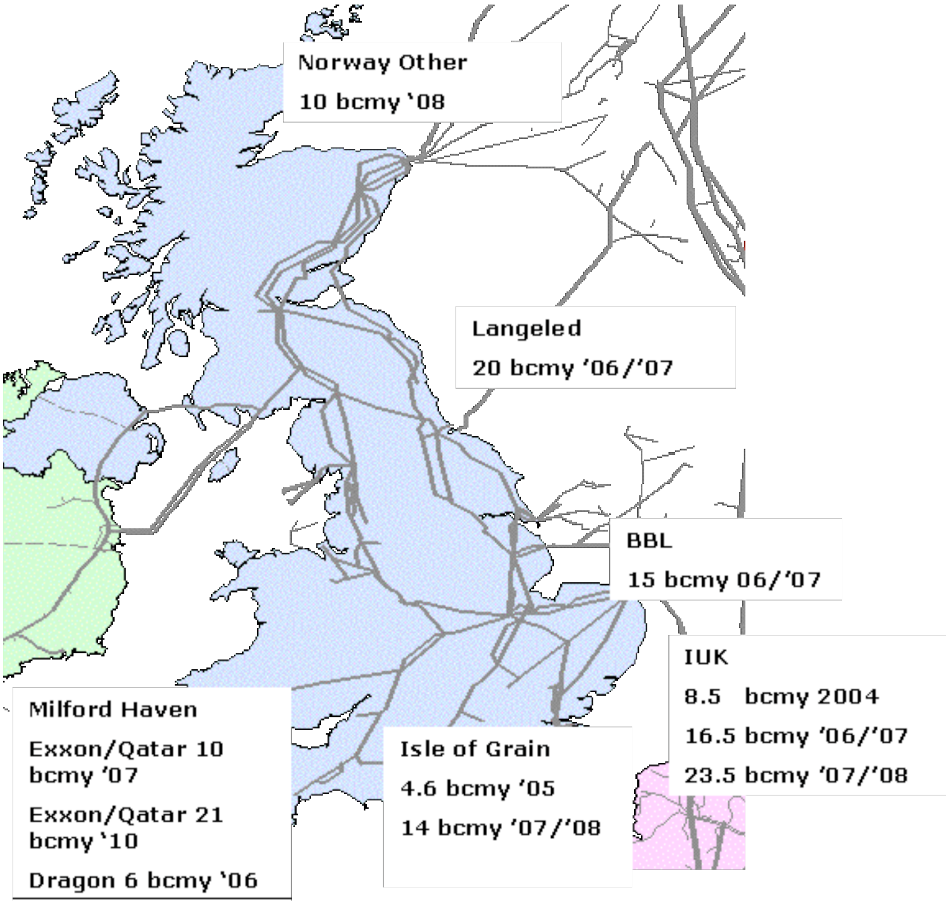


FIGURE 1

Improved security of supply

2.10. In the early guidance procedure Gastransport Services indicated that on a European scale it is important for a second physical link to be established between the large markets of the UK and Continental Europe, thus increasing the scope for arbitrage and the sourcing of gas from a greater diversity of sources. Further, the BBL enhances security of supply through the establishment of a connection to new sources and the increased opportunity (as exemplified by the open season procedure) for new entrants to target the UK market. The BBL project strengthens both delivery of capacity and security of supply in the European single market, especially for the United Kingdom, which will gain a new supply route along which the expected supply-side deficits in the UK can be alleviated. The United Kingdom may also benefit from the increased possibilities for new entrants to the UK gas market that the BBL offers. For Continental Europe, having the ability to carry gas to the most liquid market will also have a beneficial effect on the operation of the internal market.

2.11. Moreover, it was indicated that the BBL forms a potential part of the Baltic pipeline, enabling a connection with the enormous Russian gas reserves. Building the BBL could in fact have a positive effect on the establishment of a link to the Baltic pipeline in the Netherlands, thus increasing security of supply for both the UK and the Netherlands. BBL Company is convinced that the BBL pipeline will play an important role in bringing Russian gas to the UK in the future.

2.12. The DTI and Ofgem monitor energy security in the UK gas and electricity markets through the Joint Energy Security of Supply Working Group (JESS), which publishes a twice-yearly report.

2.13. In its report of May 2004, JESS concludes that there will be an increasing need for new gas supply sources as well as investment in infrastructure projects to meet both annual demand and the seasonal and daily swings in demand as production from the UK Continental Shelf (UKCS) declines and the UK becomes more dependent on imported gas in the next twenty years. Jess identifies a number of potential outcomes:

- Additional import connections from Norway, direct to shore or via existing UKCS infrastructure;
- Liquefied natural gas (LNG) terminals to import gas from worldwide sources;
- More interconnection with Europe to import gas from the Netherlands, Norway and beyond;
- Pipeline upgrades to existing interconnectors to increase import capacity;
- Gas storage, both onshore and offshore, to provide additional seasonal and daily swing capacity and to replace capacity which will be lost with the decline in UKCS swing capacity.

2.14. The JESS report further states that investment forecasts suggest that the market can respond to the demand for gas in the UK in the next decade and demonstrate that peak gas demand or sustained high demand could be met with maximum supplies from existing and new development projects, although this will be dependent upon implementation of some of the less certain projects. According to the JESS report it is important that a sufficient proportion of the projects currently under consideration proceed to full-scale development in a timely fashion. NationalGridTransco has also identified this “gap” in their winter operations report.

2.15. The BBL is one of the projects that can provide a new source of gas to the UK to offset the “supply gap”, through both base load supply as well as the opportunity to deliver flexibility to the UK market, depending on the actual usage of the BBL pipeline by its shippers.

2.16. The BBL transmission contracts do not specify a minimum load factor or other limiting requirements as to the use of the transmission capacity (with an exception to the Use It Or Lose It (“UIOLI”) rules). The BBL may, apart from its contribution to the availability of gas (to meet the growing gap between supply and demand), therefore be used to enhance the availability of capacity and flexibility to the UK gas market as well as the continental markets.

2.17. The outcome of the open season means that the physical flow direction of the BBL will be from the Continent to the UK. However, the BBL transmission contracts explicitly allow for contractual counter flows and BBL Company envisages offering these contractual reverse flow services on an interruptible basis. The reverse flow possibilities (be it through swaps or primary interruptible services) create arbitrage opportunities that have a beneficial effect on competition and security of supply in the Netherlands and the Continent. Because some shippers in the BBL will carry their gas from further a field than Balgzand, such as the Bunde area, the scope for arbitrage is enhanced to cover gas that was not already available to the Dutch gas market and thus improves the scope for enhancing security of supply in the Netherlands (see also paragraph 2.63.).

B. Meeting condition b; Risk assessment

2.18. The comfort letters from national and European authorities were an essential factor in the decision making process for the BBL investment. Had these comfort letters not been forthcoming the decision to proceed with the project would not have been taken.

2.19. In the course of the early guidance procedure, a number of issues related to the risk assessment (other than the usual risks associated with projects of this size) of an infrastructure project such as the BBL were considered:

a. First of all the *size of the investment* was considered.

b. Secondly, the *competitive position* was considered, as competing projects would have an impact on the tariffs that could be negotiated.

c. Thirdly, *the regulatory environment* has a direct impact on the risk assessment of the project developers. It was indicated that for the decision to construct the BBL, it was essential to have certainty regarding the contracted capacity and the applicable tariff. Any uncertainties in this regard, as might have been introduced, for example, by the possibility of periodical downward revision of the tariff level by regulatory bodies or by additional rules governing capacity management or shortening the contract duration, would have increased the investment risk appreciably and would have meant that the investment would not have taken place.

d. Finally, the fact that BBL Company is a financially and legally *independent company* has relevance for the financing of the company and thus for the risk position

Size of the investment

2.20. The BBL represents a very large investment. In the early guidance procedure an indicative schedule of financial obligations related to the BBL was included. The total capital expenditure investment in infrastructure for the BBL pipeline (based on a 36’’ pipeline) is estimated at 500m EUR. On top of this an indication of the expected operational expenditures was given to the relevant authorities.

Competitive position of the BBL

2.20. For shippers wishing to ship gas from the Continent to the UK, the BBL will be subject to competition from other possible infrastructure projects and notably the Interconnector UK. IUK has two reverse flow expansion projects planned, the first of which is under construction. In the course of the discussions held for the open season procedure, (potential) shippers indicated the IUK as a real alternative to committing to the BBL.

2.21. The competitive position of the BBL during the open season vis-à-vis the IUK can be further explained by a tariff comparison. The Interconnector is currently increasing its capacity for reverse flow (i.e. for flows to the UK), which is being installed through extra compression at Zeebrugge. This extra capacity was being marketed at an indicative tariff of 33 Euro/m_ (35.17)/hr/yr. From the table below it may then be concluded that the indicative tariff used for the BBL is just competitive for gas heading to Bacton, but leaves no room for further increases:

Tariff comparison	**(€/m3/hour/year):**
TTF - IC - NBP:	84
TTF - BBL - NBP:	87
TTF is Title Transfer Facility in the Netherlands BBL is based on indicative tariff of 65 €/// IC is based on indicative tariff of 0,8 p/th for IC-extension (33 €///)	

2.22. The competitive situation of the BBL is notably important when considering the risks relating to regulatory involvement in tariff setting and other access conditions such as the duration of contracts and the allocation of capacity.

2.23. Another issue related to the competitiveness of the market and the risk assessment for infrastructure developers such as BBL Company is that in a competitive market, transportation costs must necessarily be limited to enable shippers to sell their gas competitively using any particular transmission system. The BBL will be used to transport gas to a competitive UK (end user) market (as exemplified by the ADL report). If tariffs for the BBL were set too high and the result is that gas transported through the BBL becomes uncompetitive with other sources of supply then either tariffs will have to be reduced or the system will not be used. Moreover, if a number of international companies are prepared to sign up to long term purchase of transmission capacity in projects such as the BBL, this must then mean that the return to BBL Company is reasonable.

Risk and the regulatory framework

2.24. A number of specific risks that distinguish the BBL project from other infrastructure projects have been pointed out in the course of the comfort procedure. These risks are notably related to the fact that the BBL is a sub-sea interconnector in one of the busiest shipping lanes in the world, connecting markets in two different nations. Another specific risk that the BBL project faces relates to the regulatory and legal framework. This risk may be attributed to a large extent to the recent adoption of the EU Gas Directive (2003/55/EC), the provisions of which lead to changes in the existing legal framework. Furthermore, international experience with regulatory involvement in access conditions and tariff setting shows that the regulatory ground rules may change significantly at (ir-) regular intervals and such changes have invariably been to the detriment of the infrastructure owner[3,4].

2.25. In other words, even if a favourable regulatory regime were offered at the outset (which would not necessarily be the case from the point of view of the project sponsors) there is no certainty that this would last. It is clear from regulatory experience (as is confirmed by the article referred to in the footnote to the previous paragraph) that financial markets assess the negative potential of regulatory change as adverse. This is exacerbated by the fact that ultimately, political pressures may influence regulatory policy. BBL Company stresses that the regulatory certainty that an exemption under article 22 of the gas directive allows for is formally and legally binding and that such certainty is much stronger to project sponsors than a regulatory regime, which can be altered ex-post.

2.26. Whilst it was indicated that the long term contracts (10-20 years) are needed to underpin the investment in the BBL and a considerable part of this investment will be recovered during the initial period, not all of the investments will be recovered during that time. As a consequence, risks will remain after the initial contract period. These risks are the consequence of the uncertainties regarding the sale of transport capacity after the initial contracts have expired. The break even period for the BBL project was shown to be substantially longer than the duration of the initial contracts. The initial contracts (15 and 10 years in duration) therefore do not eliminate all risk, but are important in reducing the risk for the project developers to an acceptable level.

[3] BBL Company notes that this view is also reflected in an article by Brunekreeft (University of Cambridge) and Godfried (Dte) where they state, “ a third argument is related to the regulatory uncertainty regarding new investments. In essence this argument reads that a regulatory authority cannot commit itself to not change the regulatory rules opportunistically, once the investment has been made. This problem leads to underinvestment. The Australian answer to this is a 15 year “regulatory holiday”, a legal provision that forbids regulatory involvement for that period” (translated, G. Brunekreeft and H.M. Godfried (2004), *Netverbindingen door de markt*, ESB 4429 140-141.

[4] Whereas the Australian answer to the potential problem of underinvestment is a regulatory holiday, the United States Federal Energy Regulatory Commission (FERC) hopes to encourage the construction of new LNG facilities by removing some of the economic and regulatory barriers to investment through the “Hackberry Decision”. In December 2002, open access requirements for new onshore LNG terminals in the United States were terminated, placing them on an equal footing with regulated offshore terminals. FERC authorized Hackberry LNG to provide market-based services rather than under regulated cost-of-service rates.

BBL Company considers it absolutely essential that the BBL is allowed to execute the initial contracts in an unfettered manner and therefore the exemption was requested to cover the whole period during which these initial contracts will run. To support this statement, details on the break-even calculation, as well as the detailed financial background to the BBL project have been elaborated to the national and European authorities.

2.27. Furthermore, at the request of the authorities, an analysis was made of the consequences of varying levels of regulatory involvement in the terms and conditions for the BBL and notably an analysis of the effects of a regulatory demand to reserve 20 or 25% of the transmission capacity for short-term contracts. It was concluded that the effect of such a capacity reservation would raise the indicative tariff to levels, which were deemed uncompetitive. The calculation did not include a regulatory risk premium to incorporate the risk of price reviews.

2.28. A different approach to the risk assessment and the risk “appetite” of the BBL sponsors was to assess the impact of regulatory risk on the required project return. The indicative tariff for the project was made on the assumption that an exemption according to article 22 would be granted. Based on that and other project assumptions, the required project return was set. Alternatively, it was considered that the volume and price risk in the case of a fully regulated, but unclear and possibly unstable regime would be adequately covered by setting the required project return at a higher rate. All other assumptions being identical, this would have led to a calculated tariff that is significantly higher than the indicative tariff. When set against the competitive position of the BBL vis-à-vis the Interconnector, no sufficient demand for transmission services at this tariff was expected.

2.29. Gastransport Services asked KPMG and ABN AMRO Bank to give advice on the risk profile of the BBL project in relation to the exemption request from regulated TPA. The advice from ABN AMRO and KPMG supported the exemption application in the early guidance procedure, as well as the required duration of that exemption.

BBL Company is an independent company

2.30. A major factor in the risk assessment is the fact that BBL Company is a separate company that will own and operate the BBL at its own risk. More information on the legal structure of BBL Company is given in subsection C of this application.

C. Meeting condition c; Infrastructure owned by a separate legal entity

The BBL Company

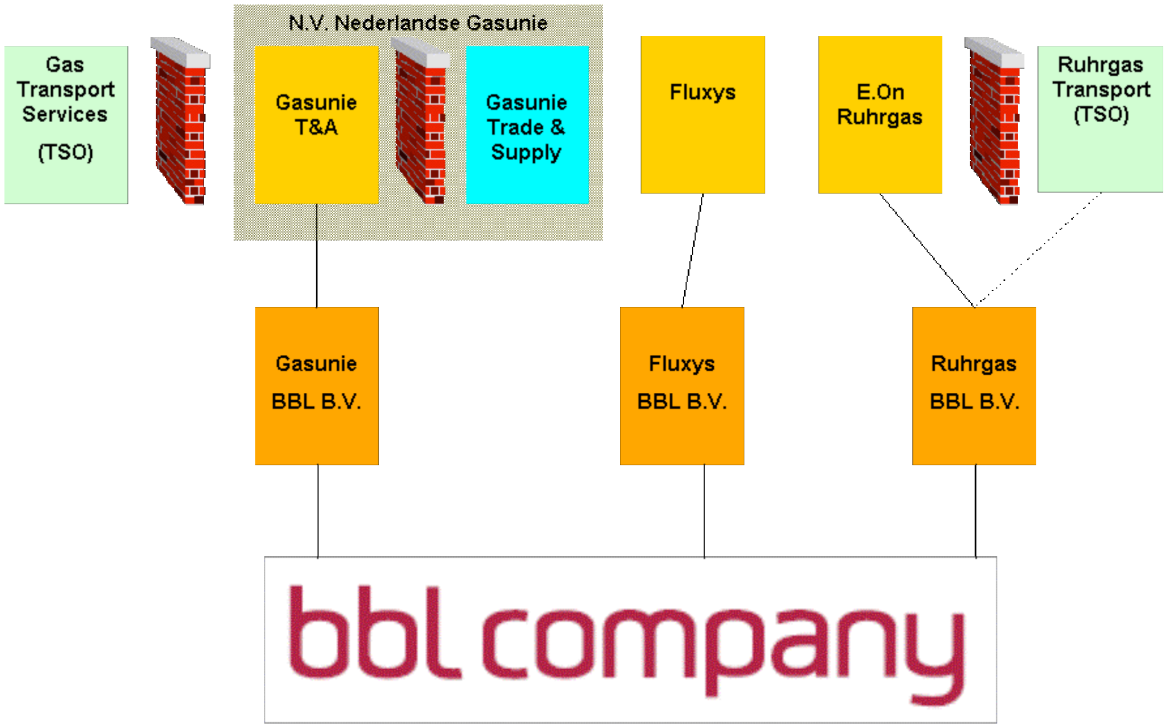
2.31. A general partnership by the name of BBL Company was established on 9 July 2004 between legally separate subsidiaries of N.V. Nederlandse Gasunie ("Gasunie"), E.ON Ruhrgas AG ("Ruhrgas")and Fluxys N.V. ("Fluxys"): Gasunie BBL B.V., Fluxys BBL B.V. and E.ON Ruhrgas BBL B.V. The object of BBL Company is the design, construction and operation - including the performance of transmission services - of the BBL.

2.32. The partnership agreement stipulates that the BBL Company will construct and own its own assets in the form of the BBL and related facilities.

2.33. The partners in the BBL Company have initially provided the financial resources of BBL Company through a capital contribution. Any (future) loans granted by the partners to BBL Company will be granted on commercial terms. BBL Company will finance itself through its own revenues. These resources will be sufficient to finance the day-to-day operations of BBL Company and the making of necessary investments for the purpose of such operations.

2.34. The BBL Company has its own management who is entitled to represent the BBL Company and manages its day-to-day operations. Although Gasunie's Asset Management business unit (Gasunie Technology & Assets) will perform the construction and operation of the BBL on the basis of service level agreements with BBL Company, BBL Company will determine its own commercial policy and commercial activities, i.e. engaging in transport agreements and related agreements with customers. The service agreement with Gasunie Technology & Assets will be entered into on an arms length basis. A schematic overview of the company structure is given below[5]

[5] The shares of the BBL B.V. partners in BBL Company are 60% Gasunie BBL B.V.; 20% Ruhrgas BBL B.V. and Fluxys BBL B.V. respectively.



2.35. Furthermore, BBL Company will appoint an Interconnector System Operator in accordance with the requirements of the Dutch legislation regarding Interconnector System Operators.

Governance of the BBL Company - Adequate separation of interests

2.36. The Dutch gas TSO (Gas Transport Services) has been established in July 2004, and has a limited role and responsibility (as defined in the Gas Act) and is only involved with regulated national transmission activities as a legally separate company. Because of this limited role for the TSO there are still transmission related activities within Gasunie. These transmission activities are the responsibility of the business unit Gasunie Technology&Assets which is separated from Gasunie Trade&Supply by way of organisational unbundling and a system of firewalls including yearly auditing thereof by independent experts and the location of Gasunie Trade & Supply in a separate building.

2.37. On the basis of the amended Dutch Gas Act, Gas Transport Services is not allowed to engage in interconnector pipelines such as the BBL. Therefore, the partnership establishing the BBL Company was entered into by Gasunie through its legally separate subsidiary Gasunie BBL B.V.

2.38. The business unit within Gasunie responsible for transmission related activities (Gasunie Technology & Assets) is also responsible for managing Gasunie's interests in Gasunie BBL B.V.

2.39. Ruhrgas holds the participation in the BBL Company through its legally separate subsidiary E.ON Ruhrgas BBL B.V. On 01 January 2004, in fulfilment of one of the requirements of the ministerial approval authorizing E.ON's acquisition of Ruhrgas, Ruhrgas transferred its gas transmission business to a new subsidiary, E.ON Ruhrgas Transport ("ERT"). ERT has sole responsibility for the gas transmission business, including technical responsibility for the transmission system, and functions independently of Ruhrgas' sales business.

2.40. ERT acts under its own responsibility as a commissioner for Ruhrgas to safeguard Ruhrgas's transport interests related to its BBL shareholding. The transmission activities of ERT are separated with adequate ring fencing measures from the trade and supply activities of Ruhrgas. ERT has a separate place of business, and access to the building and the particular workplaces are protected by an electronic access system. The ERT IT-systems are accessible for ERT employees only. Furthermore, according to the ERT corporate terms, the managing directors of ERT are obliged to preserve the confidentiality of commercially sensitive information obtained in the course of carrying out its business, and shall prevent information about their activities which may be commercially advantageous from being disclosed in a discriminatory manner. In addition, a compliance programme for ERT employees setting out the measures taken to ensure non-discriminatory conduct of the transportation business will be set up in the near future.

2.41. Fluxys is a company which is legally separated from Distrigas, the Belgian gas trading & supply company. The two companies are unbundled since November 2001: Fluxys is responsible for natural gas transmission activities whereas Distrigas is responsible for natural gas trading. The respective frame activities of the two companies are thus completely distinct from each other in anticipation of the European Gas Directive.

2.42. As a stock market listed company, Fluxys is subject to the control of the *Bank Commission* and applies the principles of Corporate Governance as provided by law or as recommended by the *Bank Commission*. It has to be underlined that Fluxys has appointed five independent directors instead of three, as provided by the Corporate Law.

2.43. In accordance with the Belgian Gas Law Fluxys is also subject to the control of a Regulator (CREG). In this framework, several regulatory requirements are to be applied by Fluxys such as a Code of Conduct and the designation of a Compliance Officer who is charged with the implementation of measures to preserve the confidentiality of information and to prevent discriminatory behaviour.

2.44. For the purpose of clarification, Fluxys does not participate in the UK – Belgium Interconnector (Interconnector (UK) limited).

Separation from connected system operators

2.45. From the above it follows that the separation criterion with regard to the Dutch system operator GTS is met. Since the relation with the UK system operator, Transco plc., will be purely contractual, through a Network Entry Agreement, the separation criterion is also met in the UK.

D. Meeting condition d; Charges are levied on the users of the infrastructure.

Open season and Initial contracts

2.46. Access to the BBL – through long-term contracts- was offered to shippers on the basis of an open season. As such the open season is the methodology used for initial capacity allocation as well as for the determination of the applicable tariff. In the brochure marking the start of the open season, an indicative tariff was given, and it was indicated that economies of scale could influence the final tariff. In the course of the open season a tariff schedule outlining the total tariff change as a function of the capacity contracted was discussed with potential shippers.

2.47. The open season was announced during the Flame Conference in Amsterdam, 17 March 2003 in presence of the entire European gas industry. At this conference almost 500 brochures outlining the open season procedure for the BBL were distributed. At the same time (full-page) advertisements in the Financial Times and the Dutch Financieel Dagblad were run, targeting those not present at Flame. Also a BBL web site was launched that was easily reached through a link on the Gastransport Services web site. All of Gastransport Services' business relations were informed by email of the launch of the BBL web site.

2.48. After this first announcement some 18 companies, from a variety of European countries and ranging from producers through fully integrated energy companies to pure traders, expressed their interest in the project. All received a questionnaire by email asking them to identify their desired capacity and entry point in preparation for exploratory meetings. During and after this first round of meetings several companies withdrew. There were a variety of reasons for these withdrawals, for instance some potential shippers did not yet have a gas sales contract to back a long-term transportation contract. Another reason was that companies were winding down activities or decided it did not fit with their current plans or strategies.

2.49. Follow up discussions were held with the remaining 6 companies with the aim of concluding a letter of intent to commit to capacity in the BBL. During these discussions transmission service terms and conditions were discussed in greater depth and a fine-tuning of the draft transmission agreement took place based on the feedback of the potential customers. In this round of the negotiations several parties withdrew. Uncertainty about the final investment decision (i.e. will the pipeline be built) played a role in their withdrawal. Also competition from other projects such as the IUK expansion may have influenced decisions by potential shippers.

2.50. There was no demand from potential shippers for long-term physical reverse flow capacity. The possibility for contractual reverse flow was discussed and it was agreed that this would be possible on the basis of secondary market transactions as well as an interruptible counter flow service in the primary market by BBL Company to be detailed in a later stage.

2.51. Finally, transmission contracts were agreed with shippers Ruhrgas, Gasunie Trade&Supply and Wingas. The initial contracts have durations of 10 and 15 years, as well as differing starting dates. These initial contracts justify a 36” pipeline and the terms and conditions were determined on the basis of the final pipeline configuration.

2.52. The European Commission has – in the context of the second EU gas Directive – indicated that long term contracts will continue to be an important part of the gas supply of Member States and should be maintained as an option for gas supply undertakings insofar as they do not undermine the objectives of the second Gas Directive. The long-term contracts with shippers for the BBL are compatible with EU competition law.

Terms and conditions for further access

2.53. Notwithstanding the fact that the BBL Company is applying for an exemption from access requirements, the open season procedure was used to allocate initial capacity to the market on a non-discriminatory way. Furthermore, it is proposed that further access to the BBL will be possible in a variety of ways, all of which will contribute to the prevention of potentially anti-competitive hoarding of capacity:

a. First and foremost, the BBL Company transportation contracts allow the capacity contracted in the initial contracts to be freely tradable on the secondary market, and the BBL Company will facilitate this by means of a bulletin board for the BBL pipeline. Apart from sub-letting capacity to other shippers BBL shippers may also permanently transfer (part of) their capacity to other shippers.
b. Additionally, unused capacity will be made available to the primary market on an interruptible basis. The terms and conditions for this interruptible capacity are currently under consideration, but conditions will be consistent with the terms and conditions for the initial contracts while appropriately reflecting the interruptible nature of such capacity. The BBL Company will develop the interruptible services in a timely fashion, in order for the services to be available when the pipeline starts operation.
c. The contractual UIOLI provisions, which relate to the actual legal recovery of capacity that is not used by the original shipper for a considerable length of time, are the last building block of the capacity management system for the BBL. These provisions serve as a backstop to prevent BBL shippers deliberately tying up transport capacity.

2.54. Whilst the capacity and technical specifications of the BBL have been determined by the contracted long term capacity rights, some capacity may be available between first gas and the start of other initial contracts. Subject to the technical aspects of the realisation of the BBL, a limited amount of capacity may be available over and above the contracted long-term capacities. Insofar this capacity is physically available BBL Company will offer any such capacity (insofar there is sufficient market interest) to the market under suitable terms. The terms and conditions will need to ensure that initial contracts are not prejudiced. BBL Company would therefore also expect the exemption to apply to the contracts for the sale of any such "spare" transport capacity.

2.55. It was clarified earlier that the open season did not yield firm interest in physical reverse flows to warrant the substantial investment in compression facilities at the UK end of the pipeline. However, it will be possible for any BBL shipper who has contracted transmission capacity in the BBL to seek contractual partners with whom to enter into arbitrage or swaps. Similarly, shippers carrying gas from farther a field than Balgzand, such as the Bunde area enhance the scope for arbitrage for swaps of their capacity to the Bunde area. BBL shippers may for example seek partners for a swap and adapt their nominations accordingly. This way a contractual counter flow will effectively mean a reduction in the BBL shipper's nomination of gas quantities into the BBL in Balgzand or for example the Bunde area.

2.56. All BBL shippers will be able to enter into these counter flow contracts should they so wish. The BBL terms and conditions do not restrict the possibilities for shippers to enter into these contractual counter flows. It is understood by BBL Company that Dutch TSO GTS will further facilitate these contractual counter flows by way of making the Julianadorp exit point a non-physical entry point also. Further more, the creation of an electronic Bulletin Board by BBL Company is envisaged, similar to the way that the Interconnector UK facilitate shipper trading of capacity.

2.57. The BBL Company will of course continue to monitor the interest or demand for physical reverse flow capacity in the BBL with a view to making such physical capacity available when this interest is sufficient to warrant any possible additional investments. Again, the terms and conditions of such capacity need to be consistent with the initial contracts. BBL Company would therefore also expect the exemption to apply to future contracts for the sale of any reverse flow transport capacity.

General information provision

2.58. It has been indicated that BBL Company will provide information to regulatory authorities in accordance with current UK and Dutch legislation. This notably includes information on historic usage of the BBL, prices and conditions for access as well as contracted capacities. It was indicated in the early guidance procedure that the information will be largely similar to the current information provision in the GTS network (taking into account the differences between GTS' meshed entry-exit network system and a single pipeline system as well as any confidentiality issues). The BBL Company will use the next two years until first gas comes on stream to develop the necessary systems (such as the necessary IT systems) for information provision and is happy to maintain close contact with the regulatory authorities in order to further develop an appropriate system of information provision to the authorities and third parties.

2.59. Information provision for (potential) shippers in the BBL must be based on and be proportional to the purpose of that information which is to facilitate access to the BBL and will include:

- Prices charged for access such as prices charged for interruptible capacity on the basis of the application of anti hoarding provisions and interruptible reverse flow services (The terms and conditions for interruptible contracts are currently under consideration).
- Real time flows will be made available to actual shippers using the BBL on an on-line basis. It is expected that this will be largely similar to such information provision in the GTS network.
- Historical data on the actual usage so as to inform shippers considering a booking request for (future) interruptible capacity. This information is especially meant for those shippers who are considering a booking-request for (future) interruptible capacity. The provision of this information will be largely similar to the information provision in the GTS network on import and export capacities.
- Information on planned maintenance that may affect shippers, but information on expected flows – insofar as the BBL operator has this information - will not be published.

2.60. Information will be made available to connected TSOs in line with the requirements of the network entry / grid connection agreements and insofar as this is reasonably necessary.

2.61. BBL Company will ensure that in providing information the confidentiality of commercially sensitive data is respected.

E. Meeting condition e; No detrimental effect on the functioning of the connected networks.

2.62. Reference is made here to the remarks under A (Competition and security of supply) above. It was indicated in the course of the early guidance procedure that the contractual and technical specifications of transmission through the BBL pipeline would be compatible with the requirements of the Dutch and UK gas networks. It is the responsibility of shippers using the BBL to ensure sufficient capacity booking in the UK NTS and the Dutch GTS grid.

2.63. The BBL pipeline will connect the Dutch Transmission system governed by the Dutch network operator GTS, and the UK NTS, governed by Transco. In a letter to DTe dated 30 August 2004, GTS indicated that order to enable BBL shippers to bring their gas to the BBL in Julianadorp from their entry-points in the GTS grid, Gasunie Technology&Assets will carry out a substantial investment programme on the GTS grid. It was further explained that this would mean that there is no impact on existing transit volumes or domestic gas transport flows and thus security of supply in the Netherlands will not be harmed. Instead, under A it was elaborated how the BBL could improve security of supply in both the UK and the Netherlands.

2.64. In this application, mention has been made of information provision and transparency by the BBL. Furthermore, the UIOLI rules, as well as other measures facilitating the (re-) use of actually unused capacity have been described in detail. Finally, the fact that a non-discriminatory open season procedure was used to determine the final technical specification of as well as the terms and conditions for use of the pipeline has contributed to facilitating new entry into the UK gas market. Thus, BBL Company expects the BBL to have a positive effect on competition and the effective functioning of the connected markets and this is reinforced by the ADL study referred to earlier.

3. Conclusion

3.61. In chapter 2 it was demonstrated that the criteria for an exemption under Dutch and UK law have been met. This is consistent with the information provided in the course of the early guidance procedure that was held in both the Netherlands and the United Kingdom, and was followed by an extensive exchange of information in the course of the procedure leading to the required comfort from the European Commission. Therefore, BBL Company requests the granting of an exemption from the regulated TPA regime as set out in paragraphs 1.8 through 1.15.

3.62. In this light, BBL Company would expect the exemptions as requested to be acceptable to the European Commission.