

## CREG answer to Ofgem consultation ref. 212/06 regarding National Grid Grain LNG Ltd application for exemption from section 19D of the Gas Act 1986

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### Question 1:

**Do you agree with our overall assessment that the proposed exemption should be granted, based on the examination of whether each of the exemption criteria have been met?**

(1.1) CREG is fundamentally opposed to total exemptions. Third party access (including transparency, UIOLI provisions, etc) should always apply. If necessary, exemptions could apply to tariff regulation, creating a kind of negotiated TPA. It seems essential to us that the regulator keeps ex ante control on access rules.

(1.2) The types of difficulties that occur when ex ante control has not been exerted were brought to light at Grain in 2005, with very high prices on the NBP without any unloading at Grain terminal. The market demonstrated not being working properly, raising concerns regarding security of supply. We can suppose that this situation could have been avoided if clear, public UIOLI and access rules had been established beforehand.

(1.3) Considering the problems encountered in the past, we consider that the approach should change and that the access rules and anti-hoarding measures should be established and approved by the regulator prior to the start of the operations. This would at least reduce the delay in the effective implementation of the requirements.

Furthermore, CREG would like to express additional comments on Ofgem initial views.

(1.4) Concerning the open season process, CREG considers that, in case the capacity of the extension is limited and the market has an interest for more capacity, the criteria to assess the bids should be known publicly and approved by the regulator. CREG doesn't understand why the capacity for the 3<sup>rd</sup> phase extension is fixed before the open season process (unless there would exist a technical cap on the possibility to extend the terminal).

(1.5) Regarding security of supply, the situation seems difficult to assess as long as we don't know who will hold the new capacity and where the LNG will come from. However, CREG agrees on the fact that LNG is a flexible source of energy and tends to improve security of supply insofar effective UIOLI rules are put into place.

(1.6) Ofgem considers that the investment in phase 3 of Grain extension wouldn't be realised whether an exemption is not granted. CREG expresses reservations on this, as Belgium experienced recently a terminal extension in Zeebrugge financed with long term commitments for capacity without exemption (see answer to question 3). Note that the situation of Zeebrugge terminal operator is quite comparable with the one of GLNG in terms of risk exposure and organisational structure. We do not see how it can be proved before the exemption decision is taken that an investment would not be realised unless an exemption is granted. Even if this were true, the investment can still be realised by someone else.

(1.7) The 2<sup>nd</sup> Gas Directive requires for an exemption being granted that "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". GNLG meets thus this requirement. Nevertheless, the CREG view is that this legal and accounts unbundling is not sufficient in case the infrastructure is exempted from regulation. As long as there is no operational and ownership unbundling, it may arise major conflicts of interest when managing both the terminal and the adjacent networks. A control of the costs of the terminal is in this way also necessary.

**Question 2:**

**Do you agree with the proposed duration of the exemption?**

(2.1) Insofar as an exemption is granted, a duration limited to 20 years seems appropriate. However, the CREG view is that long term contracts associated with a long term tariff control in a regulated framework is a preferable situation.

**Question 3:**

**Do you agree that the proposed exemption should be subject to re-examination by the authority, and if necessary to amendment or revocation, once the actual allocation of capacity through the open season process is known (particularly in the event that the outcome of the open season differs from that as represented by GLNG in its additional information and undertakings)?**

(3.1) Insofar as an exemption is granted, the possibility to amend or revoke the exemption is absolutely necessary, in order to make sure that the hypothesis on which the decision to grant an exemption is based, are effectively met at the end of the open season. This possibility is also needed to enforce the terminal operator and the terminal users to comply with the possible requirements set by the regulator to grant the exemption.

(3.2) Note that the possibility left to the regulator to amend or revoke an exemption induces a higher regulatory risk than a TPA where the access rules and tariffs are clearly defined for a long duration (e.g. 20 years). This type of TPA offers security to both the investor (long-term booking of capacity at fixed tariff to secure the investment) and to the users (securing long-term access to the downstream market at fixed tariff). The tariff can be regulated (rTPA) or negotiated by the parties (nTPA). Large new projects may also be granted special rate of returns for a long term within the regulated framework, without TPA exemption. The considerable scope for flexibility offered to regulators even without using the possible exemption is highlighted in the "Interpretive Note" ("Special treatment without exemption", pg. 3)<sup>1</sup>.

**Question 4:**

**Do you consider the competition assessment to be complete, and that it provides you with sufficient information on which to comment?**

(4.1) One of the assumptions to assess the impact on competition of granting an exemption is that "more than half of the bidders for this capacity are not existing customers of Grain". CREG considers that this information is not sufficient to do this assessment as it says nothing on the situation after the open season process (the potential newcomers could be unsuccessful in obtaining capacity) and the number of bidders should be "weighted" by the capacity they are asking for to have an idea of the impact on gas competition downstream.

[TBC]

**Question 5:**

**Do you agree with the assumptions underlying our competition assessment, as outlines in Appendix 4?**

[TBC]

**Question 6:**

**Do you agree with our views on the definition of the relevant market? In particular, do you consider the flexible gas market remains the appropriate market definition for considering the effect on competition for the development of a new LNG importation facility?**

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<sup>1</sup> Note of DG Energy & Transport on Directives 2003/54-55 and Regulation 1228/03 in the Electricity and Gas Internal Market – Exemptions from certain provisions of the third party access regime, 30 January 2004.

[TBC]

**Question 7:**

**Do you agree with our views that granting an exemption for Grain 3 would not have a detrimental impact on competition in any European gas market?**

[TBC]

**Question 8:**

**Do you consider that there should be any additional condition attached to the proposed exemption?**

(8.1) CREG view is that the anti-hoarding and UIOLI mechanisms as well as the requirements regarding transparency have to be approved by Ofgem prior to the extension of Grain terminal. Furthermore, the operational rules have to be made available to any potential user of the terminal in order to allow him to get ready to use the terminal if there is an opportunity to access it on the secondary market of capacity.

(8.2) Regarding the information published by GLNG, CREG considers that in addition to the aggregated daily flows at the terminal, GLNG has to publish the aggregated storage levels, according to the Guidelines for Good Practice for Storage System Operators (GGPSSO). This information would have to be available to anybody on GLNG website.

**Question 9:**

**Do you think that we should develop a guidance note on anti-hoarding arrangements to apply at LNG importation terminals?**

(9.1) A guidance note developed by Ofgem would be helpful for the terminal operators to propose efficient anti-hoarding rules. This note should include UIOLI rules that require, in order to make the secondary market effective, that unused capacity is offered sufficiently far in advance on the spot market at a fair price<sup>2</sup>. Furthermore, sanctions have to be foreseen in case that the shippers do not comply with the UIOLI rules.

(9.2) If the guidance note outlines a number of key high level principles only (cf. Consultation document, pg. 21), it seems imperative to the CREG that the practical rules developed by the terminal operator should be submitted to the regulator for approval before granting an exemption.

(9.3) The CREG is worried when reading that GLNG expects to adopt similar arrangements to those that are already in place at Grain, as initial arrangements have already demonstrated their ineffectiveness in the past and as Ofgem declared it still was having concerns shared by other markets participants on the “new” rules published on 31<sup>st</sup> July 2006<sup>3</sup>.

(9.4) Finally, CREG considers that harmonizing UIOLI and anti-hoarding rules at European level for both regulated and exempted terminals should be most helpful to achieve a European internal gas market.

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<sup>2</sup> In regulated TPA systems, the « fairness » of a price can be assessed by comparison with the regulated tariff

<sup>3</sup> Cf. Sophie Tremolet, “Revised Grain 1 UIOLI arrangements – Presentation to DSWG”, [http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/16019\\_Revised\\_Grain\\_1\\_UIOLI\\_Arrangements.pdf](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/16019_Revised_Grain_1_UIOLI_Arrangements.pdf)