Making a positive difference for energy consumers

Consultation

South Hook LNG Terminal Company LTD's application for exemption from regulated third party access for additional capacity - Our initial views and questions for consultation

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We are consulting on our minded-to position to grant South Hook Terminal Company LTD ("SHT") an exemption from regulated Third Party Access (rTPA) for additional Liquefied Natural Gas (LNG) processing capacity, estimated to be ~5.3 billion cubic meters per year (bcm/yr) ("Incremental Capacity") of natural gas. We would like views from interested parties on our minded to position. We particularly welcome responses from gas shippers, owners of LNG terminals, interconnectors and gas storage facilities. We would also welcome responses from other stakeholders and the public.

This document outlines the scope, purpose and questions of the consultation and how you can get involved. Once the consultation is closed, we will consider all responses. We want to be transparent in our consultations. We will publish the non-confidential responses we receive alongside a decision on next steps on our website at **Ofgem.gov.uk/consultations**. If you want your response – in whole or in part – to be considered confidential, please tell us in your response and explain why. Please clearly mark the parts of your response that you consider to be confidential, and if possible, put the confidential material in separate appendices to your response.

Contents

Executive summary

On 9 October 2018, South Hook LNG Terminal Company Ltd ("SHT") submitted to us an application ("SHT's application") for the Incremental Capacity of ~5.3 bcm/yr, to be exempted from regulated Third Party Access ("rTPA") for at least 25 years.[1,2] This application was made consistent with section 19C(2) of the Gas Act 1986 (as amended) ("the Gas Act").

Directive 2009/73/EC[3] (the "Third Gas Directive") provides for a system of rTPA to LNG facilities based on published tariffs and non-discriminatory prices.[4] The rTPA provisions in relation to LNG import facilities are contained in section 19D of the Gas Act. The Gas and Electricity Markets Authority (the "Authority") can exempt certain new or modified gas infrastructure facilities, including LNG importation terminals, from rTPA subject to meeting the requirements under section 19C of the Gas Act, and approval by the European Commission.

SHT LNG facility commenced operations in 2009, and currently has an annual exempt send out capacity of 21bcm/yr. The terminal has a total processing capacity of 15.6 Million Tonnes Per Annum (MTPA) of LNG and is capable of delivering up to 21 bcm per annum of natural gas into the UK National Transmission System (NTS). We granted an rTPA exemption in respect of this original capacity in 2004 for a period of 25 years from the start of commercial operations.[5]

In January 2019, the majority owners of SHT took a Final Investment Decision (FID) on the Golden Pass LNG Project ("the Project"). These owners ("Sponsors") (Qatar Petroleum ("QP") and ExxonMobil Corporation ("EM")) plan to construct an export LNG terminal ("Golden Pass") in the United States of America (US). The Sponsors plan to use the Incremental Capacity at SHT as an outlet for a proportion of volumes from Golden Pass. SHT has stated that without an exemption from rTPA, the investment to create the Incremental Capacity would not take place. In the absence of an exemption, they would have to offer the Incremental Capacity to

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[1] See SHT's application for an exemption from rTPA, pg. 2.
[2] Based on 1 MTPA LNG = 1.36 bcm/yr natural gas. Source: https://www.bp.com/content/dam/bp/business-sites/en/global/corporate/pdfs/energy-economics/statistical-review/bp-stats-review-2019-approximate-conversion-factors.pdf
[3] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:02009L0073-20190523
[4] Directive 2009/73/EC
[5] 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 final views. November 2004.

the wider market, which would mean the Sponsors would not be able to guarantee an outlet for volumes from Golden Pass.

Our initial view, based on our analysis of SHT's application against the exemption criteria set out in the legislation, is that an exemption from rTPA requirements for the Incremental Capacity should be granted, subject to certain conditions. These conditions are detailed in Appendix 1.

Please provide your views, by email, to kevin.hughes@ofgem.gov.uk by close of business on 30 March 2020.

1. Introduction

What are we consulting on?

1.1. SHT LNG facility commenced operations in 2009, and currently has an annual exempt send out capacity of 21bcm/yr for the base capacity. The exemption is equivalent to 650 GWh/d (~59 million cubic meters per day (mcm/d)), which amounts to 80% of its technical peak send-out capacity, 812.5 GWh/d(~74 mcm/d).[6,7] South Hook estimates that this capacity has an availability of over 99%. The remaining 20% of technical send-out capacity is reported to have a lower availability and is currently used only for within-day operations. This capacity is not available for sale under long-term contracts as per the terms of SHT's current exemption. SHT plans to invest in its facility, with the aim of increasing the availability of the remaining 20% of its physical send-out capacity equating to 162.5 GWh/d (~15 mcm/d). Therefore, the Incremental Capacity under consideration is already available to SHT, however, they have advised that it needs to be reinforced to ensure availability is sufficient to form part of an integrated supply chain with Golden Pass.

1.2. We understand that primary rights to this Incremental Capacity will be sold, under a new long-term contract, to South Hook Gas (SHG). This capacity is expected to be sold under similar terms as the existing capacity contract between SHT and SHG, which applies to the base capacity. SHT wishes to obtain an exemption for a period of 25 years from operating under an rTPA regime for the Incremental Capacity, which is currently estimated to be 3.9 MTPA of LNG (~162.5 GWh/d, or ~5.3 bcm/yr of natural gas).[8]

1.3. Whilst the aim of the investment is to improve the availability of this capacity, it is our understanding that the Incremental Capacity will have a lower availability than the current exempt capacity. Further, we understand that the terminal facilities associated with the Incremental Capacity will provide back up to the base capacity, should it be required. In other words, the base bapacity will take precedence over the Incremental Capacity, and preference

[6] Based on 1 GWh/d = 0.091 mcm/d. Source: [National Grid Gas Ten Year Statement - Appendix 6]
[7] Technical peak send-out capacity for SHT is estimated to be 812.5 GWh/d. Source: SHT's application. By 'peak send-out', we mean the maximum flow rate of gas which could be provided to the National Transmission System, from SHT, at any given time.
[8] Based on 1 MTA = 1.36 bcm/yr. Source: https://www.bp.com/content/dam/bp/business-sites/en/global/corporate/pdfs/energy-economics/statistical-review/bp-stats-review-2019-approximate-conversion-factors.pdf

will be given to original primary capacity holders. This risk of operational disruption to the Incremental Capacity is acknowledged by the Sponsors.[9]

1.4. The Sponsors are two of the three owners of SHT, are also the owners of the Golden Pass terminal (see Table 1). This export terminal is due to be built in the US, and FID was taken in January 2019. The investment at SHT is considered necessary to provide the Sponsors with a guaranteed[10] outlet for export volumes from the planned Golden Pass terminal.

Facility	Ownership (percentage)
Golden Pass Export LNG terminal	QP (70) / EM (30)
Qatargas II Export LNG terminal	QP (67.5) / EM (24.15) / Total (8.35)
South Hook Terminal	QP (67.5) / EM (24.15) / Total (8.35)
South Hook Gas	QP (70) / EM (30)

Table 1: Ownership structure of projects relevant to this application. Source: SHT's exemption application.

Questions for Consultation

Relevant Legislation

1.5. Our questions to industry are framed around two sections of the Gas Act, and one Article of the Treaty of the Functioning of the European Union ('the Treaty'). In reaching our decision on the exemption application we need to consider whether the requirements of these legal provisions are satisfied.

1.5.1. Section 19C of the Gas Act sets out the requirements to be eligible for an exemption from rTPA, and Section 19DB sets out the criteria for allocation of capacity in exempt facilities.

1.5.2. Article 194 of the Treaty lays out the principle of solidarity between Member States.

[9] SHT's application. Section 3.2

[10] References in this consultation to "guaranteed" import route are to the Sponsors access rights to SHT for the period of the requested exemption. As noted in paragraph 1.3 such access may be subject to some operational disruption and this is noted in SHT's application (which makes reference to the fact that the investment cost will be balanced with the risk of operational disruption to the Incremental Capacity, due to its reduced availability).

Consultation Questions

1.6. The structure of the document and our questions for each section is set out below:

Section 1: Introduction

1.7. This section summarises the document, and introduces our consultation questions.

Section 2: Section 19C of the Gas Act 1986 (7a, 7c & 7d), and Article 194 of the Treaty

1.8. This section looks at whether or not the investment should be considered a modification to provide for a significant increase in the capacity of the facility, or to enable the development of new sources of gas supply. This section also summarises SHT's view on how the Project meets the exemption criteria as laid out in section 19C subsection (7)(a), (c) and (d) of the Gas Act.

1.9. Questions in this section:

1.9.1. Do you agree that the proposed increase in capacity at South Hook means that SHT should be eligible to apply for an exemption under section 19C(2B) of the Gas Act?

1.9.2. When considering section 19C(7)(a) of the Gas Act and Article 194 of the Treaty, do you agree with our view of the impact to Security of Supply, and the potential impact of the exemption on the interests of the EU and other Member States in the field of energy?

1.9.3. When considering section 19C(7)(d) of the Gas Act, do you agree with our views on ownership and charging?

Section 3: Section 19C of the Gas Act 1986 (7b)

1.10. This section summarises SHT's view on how the Project meets the exemption criteria as laid out in section 19C subsection (7)(b) of the Gas Act. We set out our view on SHT's arguments.

1.11. Question in this section:

1.11.1. When considering section 19C(7)(b) of the Gas Act, do you agree with the rationale we have used, and the conclusion we have come to, regarding the investment risk test?

Section 4: Section 19C of the Gas Act 1986 (7e)

1.12. This section summarises SHT's view on how the Project meets the exemption criteria as laid out in section 19C subsection (7)(e) of the Gas Act. We set out our view on SHT's arguments.

1.13. Questions in this section:

1.13.1. Do you agree with our views that granting an exemption for the Incremental Capacity at SHT would not have a detrimental impact on competition in the downstream European gas market?

1.13.2. Do you consider that our metrics for assessing competition in the market are suitable?

Section 5: Section 19DB of the Gas Act 1986

1.14. This section summarises SHT's view on how the Project meets the exemption criteria as laid out in section 19DB of the Gas Act, regarding the capacity allocation mechanism. We also set out our view on SHT's arguments.

1.15. Questions in this section:

1.15.1. Do you agree that SHT has appropriate secondary trading mechanisms in place, to ensure that unused capacity is used as efficiently as possible?

1.15.2. Do you believe there to be any unnecessary barriers to entry for use of SHT capacity, via secondary mechanisms?

1.15.3. Considering the application for an exemption from rTPA for the Incremental Capacity at the SHT and our analysis as a whole, is there any other factor you believe must be considered before we finalise our decision?

Consultation stages

1.16. This consultation will follow the stages as laid out below:

1.16.1. Consultation open (14 February 2020)

1.16.2. Consultation closes (30 March 2020)

1.16.3. Consultation decision

How to respond

1.17. We want to hear from anyone interested in this consultation. Please send your response to kevin.hughes@ofgem.gov.uk by close of business on 30 March 2020.

1.18. We welcome views from all interested parties on SHT's application and the questions set out above.

1.19. We will publish non-confidential responses on our website at www.ofgem.gov.uk/consultations.

Your response, data and confidentiality

1.20. You can ask us to keep your response, or parts of your response, confidential. We'll respect this, subject to obligations to disclose information, for example under the Freedom of Information Act 2000, the Environmental Information Regulations 2004, statutory directions, court orders, government regulations or where you give us explicit permission to disclose. If you do want us to keep your response confidential, please clearly mark this on your response and explain why.

1.21. If you wish us to keep part of your response confidential, please clearly mark those parts of your response that you *do* wish to be kept confidential and those that you *do not* wish to be kept confidential. Please put the confidential material in a separate appendix to your response. If necessary, we'll get in touch with you to discuss which parts of the information in your response should be kept confidential, and which can be published. We might ask for reasons why.

1.22. If the information you give in your response contains personal data under the General Data Protection Regulation 2016/379 (GDPR) and domestic legislation on data protection, the Gas and Electricity Markets Authority will be the data controller for the purposes of GDPR. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. Please refer to our Privacy Notice on consultations, see Appendix 3.

1.23. If you wish to respond confidentially, we'll keep your response itself confidential, but we will publish the number (but not the names) of confidential responses we receive. We won't link responses to respondents if we publish a summary of responses, and we will evaluate each response on its own merits without undermining your right to confidentiality.

General feedback

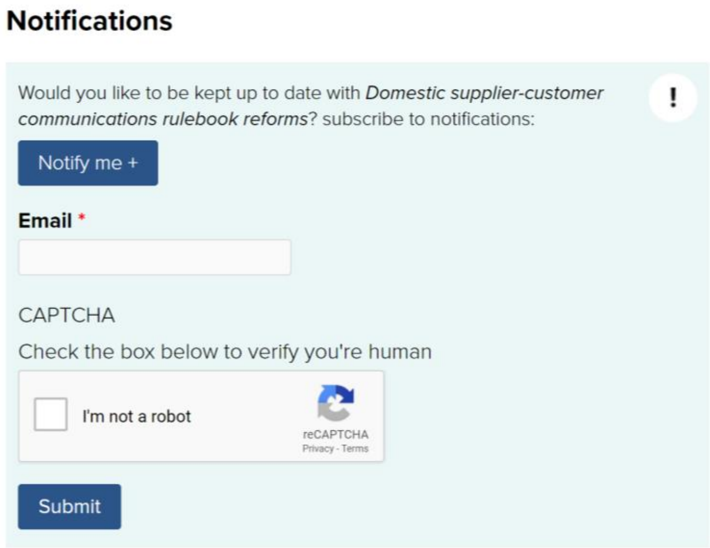
1.24. We believe that consultation is at the heart of good policy development. We welcome any comments about how we've run this consultation. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall process of this consultation?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Were its conclusions balanced?
5. Did it make reasoned recommendations for improvement?
6. Any further comments?

Please send any general feedback comments to stakeholders@ofgem.gov.uk

How to track the progress of the consultation

You can track the progress of a consultation from upcoming to decision status using the 'notify me' function on a consultation page when published on our website. Ofgem.gov.uk/consultations.



Once subscribed to the notifications for a particular consultation, you will receive an email to notify you when it has changed status. Our consultation stages are:

Upcoming ► Open ► Closed (awaiting decision) ► Closed (with decision)

2. Section 19C subsections 2B and subsection 7(a), (c) & (d) of the Gas Act – SHT's submission and our initial views

Section summary

This section provides an overview of SHT's views on how the application meets the exemption criteria, as detailed in 19C(2B) and 19C(7)(a)(c)(d) of the Gas Act. We also give our initial views on why we consider SHT to have met each criteria. This chapter also considers the impact of the exemption by reference to the principle of energy solidarity laid down in Article 194 of the Treaty of the Functioning of the European Union (the Treaty).

We have split the criteria 19C(7)(b) & 19C(7)(e) of the Gas Act into their own chapters, as these criteria require a more detailed examination.

Questions

Question 1: Do you agree that the proposed increase in capacity at South Hook means that SHT should be eligible to apply for an exemption under section 19C(2B) of the Gas Act?

Question 2: When considering section 19C(7)(a) of the Gas Act and Article 194 of the Treaty, do you agree with our view of the impact to security of supply, and the potential impact of the exemption on the interests of the EU and other Member States in the field of energy?

Question 3: When considering section 19C7(d) of the Gas Act , do you agree with our views on ownership and charging?

Eligibility to apply - 19C(2B)[11]

2.1. Section 19C(2B) of the Gas Act allows for an application for an exemption from rTPA to be made in respect of a proposed modification to an LNG import or export facility with a view to provide for a significant increase in the capacity of the facility, or to enable the development of new sources of gas supply.

2.2. We consider that ~3.9 MTPA (~5.3 bcm/yr) represents a significant increase in capacity, given that this represents 20% of SHT's current peak technical send-out capacity, and is equivalent to up to ~6% of gas supplied to GB in 2018.[12]

2.3. We also note that this increase in exempt capacity would facilitate the development of a new source of gas supply to GB, and Europe (i.e. Golden Pass LNG export terminal).

2.4. In summary, it is our view that the proposed modification at SHT satisfies the requirements of section 19C(2B) of the Gas Act and therefore should be eligible to apply for an exemption from rTPA requirements.

2.5. We set out below our assessment as to the satisfaction of the section 19(7)(a), (c) and (d) below. In this context, Section 19C(6A) of the Gas Act requires us when deciding whether the subsection (7)(a) and (d) and (e) are met that we must take into account the way in which capacity is to be allocated under the capacity allocation mechanism (approved in accordance with Section 19DB of the Gas Act). This is reflected in the relevant sections below.

2.6. As set out in Chapter 5, we have reviewed the proposed capacity allocation mechanism and consider that it satisfies the relevant requirements of Section 19DB of the Gas Act.

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[11] Section 19C(2B): A modification (or proposed modification) falls within this subsections if it is-
(a) a modification of an LNG import or export facility to provide for a significant increase in the capacity of the facility; or
(b) a modification of an LNG import or export facility to enable the development of new sources of gas supply.

[12] Based on GB gas supplies totalling 87.3 bcm/yr. Source: https://www.ofgem.gov.uk/data-portal/gas-demand-and-supply-source-month-gb

Security of supply – 19C(7)(a)

2.7. Section 19C(7)(a) of the Gas Act requires that the modification will promote security of supply.[13]

SHT's view

2.8. It is SHT's view that the Incremental Capacity at SHT will lead to a further reduction in Europe's reliance on natural gas via pipelines. SHT note that its LNG facility has been amongst the most utilised terminals in Europe, on account of the reliability of deliveries from Qatar. SHT considers that this reliability will continue, given that the same Project Sponsors are involved in securing supplies for the Incremental Capacity.

Ofgem's initial view

2.9. We consider that SHT has provided sufficient evidence that the expansion at SHT would enhance Great Britain's (GB) security of supply by increasing LNG import capacity by approximately ~3.9 MTPA (~5.3 bcm/yr). We agree that the Incremental Capacity will increase flexibility as indigenous production is on a downward trend.[14] Europe's declining domestic production of gas from the North Sea, Netherlands, Germany and Norway leaves a growing gap for LNG to fill.

2.10. Given the current information on the source of supply for the additional LNG capacity from the US, we also note that the expansion could have a positive impact on both the United Kingdom's (UK), and the EU's diversity of gas supply, and contribute to the diversification of sources of LNG imports.

2.11. In deciding whether the requirement of subsection (7)(a) is met, we have taken into account the way in which capacity is to be allocated under the capacity allocation mechanism approved in accordance with section 19DB of the Gas Act. The proposed capacity allocation mechanism includes secondary trading and anti-hoarding provisions. SHT has confirmed that unused capacity which is not sold on the secondary market will be offered to the market under Use it or Lose it (UIOLI) arrangements. Our understanding is that the proposed

[13] Section 19C(7)(a) Gas Act: the facility or (as the case may be) the modification will promote security of supply.
[14] Source: https://www.ogauthority.co.uk/data-centre/data-downloads-and-publications/production-projections/

capacity allocation mechanism in respect of the Incremental Capacity is consistent with the mechanism applied to the base capacity. These measures and mechanisms ensure unused capacity will be offered to potential users, therefore contributing to security of supply. We consider that the CAM assists in ensuring the security of supply.

2.12. We therefore consider that the requirements of subsection 7(a) of the Gas Act have been met.

2.13. In light of the recent General Court judgment in the OPAL case[15], we have also considered the merits of the exemption in light of the principle of energy solidarity.[16]

2.14. In their decision in case T-883/16, the General Court concludes that: '*…the Member States to endeavour, in the exercise of their powers in the field of energy policy, to avoid adopting measures likely to affect the interests of the EU and other Member States as regards security of supply, its economic and political viability, the diversification of supply or of sources of supply, and to do so in order to take account of their interdependence and de facto solidarity.*"[17]

2.15. In our view, the granting of this exemption to SHT is not expected to negatively affect the interests of the EU or other Member States as regards security of supply, its economic and political viability, the diversification of supply or of sources of supply, and having regard to interdependence and *de facto* energy solidarity. We have come to this position based on the following:

2.15.1. We note that SHT's analysis in the exemption application concludes that the effects of the exemption on competition in the European Economic Area (EEA) wholesale gas market is likely to be negligible.

2.15.2. This Incremental Capacity represents ~2.5% of EU regasification capacity, based on current EU capacity and that under construction.[18] This would

[15] Case T-883/16 Poland v European Commission EU:T:2019:567. http://curia.europa.eu/juris/documents.jsf?num=T-883/16
[16] Article 194 of the Treaty is set out in Annex 2.
[17] Case T-883/16 Poland v European Commission EU:T:2019:567. http://curia.europa.eu/juris/documents.jsf?num=T-883/16, paragraph 73 of judgement
[18] https://www.kslaw.com/attachments/000/006/010/original/LNG_in_Europe_2018_-_An_Overview_of_LNG_Import_Terminals_in_Europe.pdf?1530031152
https://www.igu.org/sites/default/files/node-news_item-field_file/IGU%20Annual%20Report%202019_23%20loresfinal.pdf
https://www.sourcewatch.org/index.php/Delimara_Malta_LNG_Terminal

lead to SHT's total capacity representing 12.9% of total EU regasification capacity, as compared to 10.5% were the exemption not granted. We do not consider this increase to the UK's capacity to be significant enough to cause any negative impacts to the EU, or other Member States, in the field of energy. In fact, our view is that granting this exemption may have positive effects (see paragraph 2.10).

2.15.3. We are also of the opinion that secondary trading mechanisms, and anti-hoarding measures will help to reduce any potential negative impacts to the EU or other Member States.

2.15.4. We further note that LNG trade responds to price signals, and that an exemption at SHT would not necessarily mean that LNG from Golden Pass will be delivered there. If there is greater demand for LNG in other parts of Europe, and the market conditions reflect this, then the LNG may be delivered there instead of SHT.

Ownership and Charging– 19C(7)(c) & (d)

2.16. Section 19C(7)(c) of the Gas Act requires that the facility is or will be owned by a person separate from the operator of the gas transmission network. Our initial view is that we are satisfied that this requirement will be met. The owner of the facility will be the South Hook LNG Terminal Company Ltd, a joint venture between Qatar Petroleum LNG Services (QG II) Limited and ExxonMobil Qatargas (II) Terminal Company Limited. GB's gas transmission network is owned and operated by National Grid Gas plc. As such, the facility will be owned by a person separate from the operator of the gas transmission network.

2.17. Section 19C(7)(d) of the Gas Act requires that charges be levied on the actual users of the capacity or the increase in its capacity. SHT has confirmed that this will be the case and that unused capacity which is not sold on the secondary market will be offered to the market under UIOLI arrangements (as set out in the proposed capacity allocation mechanism).

2.18. Tariffs will be applied to SHG for Incremental Capacity under a throughput agreement to be entered with SHT. Consistent with arrangements for the base capacity, any capacity that is not required by SHG or not traded through the secondary market by SHG, will be

https://www.sourcewatch.org/index.php/Bilbao_LNG_Terminal offered for third party access on non-discriminatory terms by SHT. Therefore our initial view is that the requirements of subsection (7)(d) are met.

3. Section 19C, subsection 7(b) of the Gas Act – SHT's submission and our initial views

Section summary

This section provides an overview of SHT's views on how they have met the investment risk exemption criterion, as detailed in section 19C(7)(b) of the Gas Act. We also give our initial views on why we consider SHT to have met this criterion.

Question

Question 1: When considering section 19C(7)(b) of the Gas Act, do you agree with the rationale we have used, and the conclusion we have come to, regarding the investment risk test? Are there any additional observations or comments that you would like to make?

3.1. To benefit from an exemption from rTPA requirements, the level of risk must be such that the investment to construct the facility would not be made without the exemption.[19]

SHT's view

3.2. SHT plans to invest in their terminal in order to provide an outlet for a proportion of the export volumes expected from Golden Pass. When SHT submitted its original application, the Sponsors forecast that Golden Pass would be operational from 2023 and SHT's market analysis is based on that. The Sponsors now believe that Golden Pass will become operational (slightly later) in 2024. SHT has advised that without an exemption for the Incremental Capacity, there would be no guarantee that SHG would be awarded the import capacity, putting the value chain of the wider Project at risk, as there would be no certain import route for that capacity into Europe.

[19] Section 19C(7)(b) Gas Act: the level of risk is such that the investment to construct the facility or (as the case may be) to modify the facility . . . would not be or would not have been made without the exemption.

3.3. The level of investment required in SHT to improve the availability of the Incremental Capacity is comparatively small relative to other, previous GB LNG investments. Despite this, SHT is clear that this investment would not be made in the absence of the larger investment being made to construct Golden Pass.

3.4. In support of this, as part of its application SHT provided details of a market test that they carried out in 2018. The market test was used to ascertain the level of interest that there may be from third parties to purchase regasification capacity at the terminal. The market test noted that the Incremental Capacity would be subject to potential interruptions in availability (as described in section 1 above). No enquiries were received by SHT in response to the market test. SHT considers that this indicates that the level of risk associated with the expansion of SHT is such that without the exemption (to allow for imports from Golden Pass) there would be no investment case for the expansion. In any case, SHT is clear that the investment would not be made unless it formed part of the wider Golden Pass supply chain.

3.5. In SHT's view, the global LNG market is not mature enough to support the wider Project investment as securing terminal and shipping capacity at short notice, and in sufficient capacities, is not regarded as sufficiently certain. As such, the Sponsors (i.e. QP & EM) consider that they would not be able to rely on the global LNG market to guarantee payback for the Golden Pass integrated Project as there may be no means to get their product to market.

3.6. The exemption term requested is 25 years. SHT claims that this duration is necessary for it to be satisfied that it will make an acceptable economic return on the investment required for Golden Pass. They further state that any shortening of the exemption period would increase the investment risk such as to undermine the wider Project, potentially causing a reduction in scope or delays to the Project.

3.7. The Sponsors have provided Ofgem with confidential information about the level of investment required for the wider export Project, as well as the intended structures of the agreements between the different parties involved in the value chain.

3.8. In summary, SHT states in their application that investment to improve the reliability of the Incremental Capacity at the terminal would not be made without an rTPA exemption.

Ofgem's initial view

3.9. In assessing whether the investment would take place without an exemption we have considered the interactions between the investment in SHT and the wider Golden Pass Project. This is consistent with the approach taken in previous, similar decisions. For example, our decision on the original exemption provided to SHT considered that the facility was only one part of a wider upstream investment (Qatargas II).[20]

3.10. We have consulted the Commission Staff Working paper ('EC guidance') in assessing the application of the investment risk criterion.[21] Specifically, the EC guidance suggests that the exemption criteria should be applied according to the particular nature of the case being assessed.[22,23] In this regard, we have considered the wider Project when assessing the level of investment risk. We also note that SHT's application relates to a relatively small investment to increase the availability of the capacity of an existing facility.

3.11. SHT is clear that the investment in the facility would not be made in the absence of an exemption. We note that the market test carried out in 2018 indicated that there was no interest from stakeholders in obtaining access to this capacity, at the time.

3.12. We recognise that the investment in South Hook is (notwithstanding its size) a capital-intensive project, and the terminal cannot be used for a purpose other than LNG importation. Further, the results of the market test demonstrate that if the investment was made (absent the exemption) there would be a significantly higher risk of non-use of the increased capacity at the terminal. As a result, our view is that there is sufficient evidence to suggest that an exemption is required for the investment in Incremental Capacity at South Hook to proceed.

3.13. We note that section 19C subsection 3A(b) of the Gas Act requires Ofgem to consider the length of time required to recover the investment in the modification to the facility.[24] For

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[20]https://www.ofgem.gov.uk/ofgem-publications/78870/5321qpemfinalpdf, paragraph 2.42
[21] https://ec.europa.eu/energy/sites/ener/files/documents/sec_2009-642.pdf
[22]Section 1.2 (7): "*The case for granting an exemption is not per se stronger for any type of eligible infrastructure but needs to be evaluated on a case by case basis according to the criteria…*"
[23]Section 1.3 (12): "*It is the particular characteristics of the investment project and of the markets concerned that determine the need and the scope of a possible exemption.*"
[24] Section 19C(3A) Gas Act: When determining a term under subsection (3) the Authority must take into account-
(a) the capacity of the facility or (as the case may be) the increase in capacity of the facility;
(b) the length of time required to recover the investment in the facility or (as the case may be) the investment in the modification; and
(c) the implications of the exemption for the operation of the gas market in Great Britain.

the reasons set out above, and following discussions with the European Commission, we are minded to consider the investment in the Golden Pass Project (as a whole) when considering the length of time required to recover the investment in the SHT LNG facility, given the interdependency between them.

3.14. The Sponsors of the Golden Pass Project have provided us with confidential financial information related to their Project. We are persuaded that this analysis demonstrates that Golden Pass may reasonably be expected to require a 25 year period from first export of LNG to break even on the investment, which incorporates an Internal Rate of Return commensurate with the level of investment risk.

3.15. We note that the LNG and gas supply contracts related to the Incremental Capacity, which will establish the relationships between the different parties (across the supply chain), are yet to be finalised. However, confidential information has been provided to Ofgem advising of the agreements that the parties intend to enter into in the event that an exemption is granted. Our minded-to position is to grant any exemption subject to such agreements, or those that we consider to be equivalent, being entered into. In the event that such agreements (or equivalent) were not entered into, no exemption from rTPA would exist in relation to the Incremental Capacity at SHT.

3.16. In summary, our understanding is that SHT would not invest in increasing the availability of the capacity at the terminal without the certainty that the Incremental Capacity could be utilised as part of the Golden Pass integrated supply chain, and such that there would be an import route for a proportion of the volume planned to be exported. Further, we are satisfied that the information we have received related to the wider Project demonstrates the need for a 25 year exemption.

3.17. As such, we are minded to consider that the investment risk exemption criterion is met, subject to the conditions provided in Appendix 1.

4. Section 19C subsection (7)(e)of the Gas Act – SHT's submission and our initial views

Section summary

This section provides an overview of SHT's views on how they have met the exemption criterion detailed in section 19C(7)(e) of the Gas Act. We also give our initial views on why we consider that SHT has met this criterion.

Questions

Question 1: Do you agree with our view that granting an exemption for the Incremental Capacity at SHT would not have a detrimental impact on competition in the downstream European gas market?

Question 2: Do you consider that our metrics for assessing competition in the market are suitable?

4.1. The requirement is that the exemption must not be detrimental to competition, the operation of an economically efficient gas market or the efficient functioning of the pipeline system connected to the facility.[25,26]

[25] Article 36 of the European Gas Directive expresses this criterion in a slightly different manner whereby the investment is required to enhance competition in gas supply, as opposed to not being detrimental as set out in the Gas Act. In 2005, we considered that there were no material differences between the criteria in the Gas Act and those in the Gas Directive for the Dragon LNG exemption, Ofgem final views, February 2005, paragraph 1.3. (http://www.ofgem.gov.uk/Markets/WhlMkts/CompandEff/TPAccess/Documents1/10028_2005.pdf). We remain of the same view.

[26] Section 19C(7)(e) Gas Act: 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".

SHT's view

4.2. SHT's application analyses the effect the exemption may have on the following markets: global gas production, regional gas flows and gas supplies to the GB wholesale market.

4.3. SHT assumes in its analysis that 100% of the regasified LNG from the Incremental Capacity is sold to the market by ExxonMobil Gas Marketing Europe (EMGME).

Global gas production

4.4. SHT highlights its view on the impact of LNG to global gas flows, and provides information on the Project Sponsors' position in the global natural gas production market. SHT advises that both QP and EM each produce less than 4% of global gas production.

Regional gas supplies

4.5. SHT defines the relevant region as gas supplies to the EEA. SHT defines supplies to this area as including: indigenous production, expected flows via connected pipelines (from Russia, Algeria, Azerbaijan, Iran, Iraq and Libya), and LNG flows.

4.6. SHT considers the impact of the Incremental Capacity at SHT on EMGME's market share of the gas supply to the region. This analysis is conducted to review EMGME's predicted share of Europe's physical demand. Third party European demand forecasts provided to Ofgem have been used. This data is available up to 2033, hence the analysis of market share is not conducted for the whole of the requested exemption period.

4.7. SHT considers three scenarios to assess the potential impact of an exemption to regional gas supplies to the EEA market. In all scenarios, the following is assumed to remain constant:

4.7.1. EM's supplies from equity production in the UK, Norway[27] & Germany

[27] On 10 December 2019 ExxonMobil concluded the sale of its remaining Norwegian gas production interests to Var Energi AS. From 10 December 2019, EMGME no longer owns equity production assets based in Norway. The effect of this will be to reduce EMGME's market share below the figures quoted in the analysis. Put differently, it further reduces any risk of market concentration arising as a result of an exemption being granted.

4.7.2. Physical market demand forecast from third party gas demand data used to support the analysis.

4.8. The differences between the three scenarios are outlined in Table 2. For scenarios 2 and 3, the SHG LNG volumes are forecasted based on the historic ratio of LNG processed through the terminal (relative to other GB LNG import terminals). These ratios are assumed to remain constant in the future, and are combined with third party forecasted LNG utilisation rates to find a SHT specific utilisation forecast.

Scenario	EMGME supply assumptions	EMGME maximum predicted regional gas supply, as a percentage of predicted demand
1	Excluding SHT	2.5%, declining over time
2	Including SHT	5%, declining over time
3	Including SHT, and Incremental Capacity	6%, declining over time (to a lesser degree than scenario 2)

Table 2: A summary of the differences between the scenarios used for SHT's assessment of the impact of an rTPA exemption on the regional gas supplies market.

4.9. Further to Table 2, SHT has also considered how EMGME's market share would increase, under the conservative scenario that both the original capacity at SHT, and the Incremental Capacity to which the present exemption application relates, were both 100% utilised. In this scenario, EMGME's maximum predicted regional gas supply, as a percentage of predicted demand becomes 6.6%, declining to 5.5% by 2033. Hence the Incremental Capacity could be said to lead to a predicted increase of up to 1.6% in EMGME's maximum predicted supply to the EEA (as a percentage of predicted demand).

GB gas supplies

4.10. In its application, SHT notes that there is a significant diversity of supply sources, and extensive interconnectivity between UK, Norway and Continental Europe. SHT states that this is evidenced by the ACER Gas Target Model (GTM) analysis, which concludes that the UK complies with the GTM vision of market integration. As a result, it is SHT's view that it is not realistic to look at the GB gas market, or any sub-set of the EEA separately.

4.11. To further support their view that the GB market should not be considered in isolation, SHT points to comments in Ofgem's 2017 State of the Market report. They highlight various comments which support SHT's view that the GB market has a diverse range of supply sources, and is extensively connected with other countries, and that it is therefore not realistic to look at the GB gas market, or any subset of the EEA separately.

4.12. However, it has nevertheless studied the impact of an rTPA exemption on competition in GB gas supplies. SHT considers its share of this market under four scenarios, see Table 3. All supply assumptions include EM's forecast for 100% equity production related to the UK, 35% of Norwegian equity production[28], plus regasified LNG from SHG. This is referred to as 'base assumption' in column 2 of the table below.

4.13. Where SHG LNG volumes are included, these are forecasted based on the historic ratio of LNG processed through the terminal (relative to other GB LNG import terminals). These ratios are assumed to remain constant in the future, and are combined with third party forecasted LNG utilisation rates to find a SHG specific utilisation forecast.

4.14. SHT considers GB gas demand in two different ways:

4.14.1. Scenario 1 is based on comparing EMGME's expected supply with total volumes traded on the National Balancing Point (NBP).

4.14.2. All other scenarios, listed in Table 3, consider a demand figure based on third party gas demand forecast data.

4.15. Where Incremental Capacity supply is included, this is based on the assumption that it is 100% utilised, and all gas is sold to EMGME from SHG.

4.16. The scenarios listed in Table 3 have been applied by SHT to two standard competition indicators, the Herfindahl–Hirschman Index (HHI) and Pivotality.[29]

[28] See footnote 27.
[29] HHI is a measure of the size of firms in relation to the industry they operate in and an indicator of the amount of competition among them. It is defined as the sum of the squares of the market shares of the largest firms within the industry. If whole percentages are used, the index ranges from 0 to 10,000.

Scenario	EMGME supply assumptions	GB gas demand assumption	EMGME maximum predicted share of GB gas supplies
1	Base assumption, plus Incremental Capacity	OTC and Exchange Market Data from ICIS Heren and ICE	Up to 1% until Incremental Capacity added, rising to up to 2% thereafter
2	Base assumption, excluding SHG LNG	UK third party gas demand forecasts	Adding Incremental Capacity leads to no increase in EMGME's share of the market.
3	Base assumption	UK third party gas demand forecasts	Leads to an increase from between ~20 – 23%, to between 21 – 26%, with Incremental Capacity
4	Base assumption, plus Incremental Capacity	UK third party gas demand forecasts	Leads to an increase from between ~20 – 23%, to between 24 – 29%, with Incremental Capacity

Table 3: A summary of the differences between the scenarios used for SHT's assessment of the impact of an rTPA exemption on the GB gas supply market.

<u>HHI</u>

4.17. SHT has used HHI to conclude that the impact of an exemption for the Incremental Capacity, to market concentration, is limited. Based on an assessment of 2016/17 data, and assuming all Incremental Capacity is fully utilised, SHT finds that the HHI increases from 819 to 873. This being below the figure of 1000, values in excess of which the Competition Markets Authority (CMA) consider to be an indicator of market concentration.

4.18. According to the CMA an HHI exceeding 1,000 may be regarded as concentrated and an HHI exceeding 2,000 as highly concentrated.[30]

Pivotality

4.19. SHT has also used the pivotality model, published by Ofgem, to determine the impact to competition of an exemption for Incremental Capacity. A player is considered pivotal if total demand cannot be met from all available sources of supply controlled by other players. The model estimates whether a given market player's gas supplies are needed to meet total GB gas demand over the analysed period (i.e., either a day, a week, a month, a quarter or a season out of a year). That is, for every gas year considered, our model analyses whether a given market player's supplies are 'pivotal' in meeting total GB gas demand in each of 365 days, 52 weeks, 12 months, 4 quarters or 2 seasons.[31]

4.20. SHT found, using the illustrative capacity coefficients from the original Ofgem model, that EMGME could be pivotal over a quarter, and a season. SHT considers that these coefficients are too low, and that minor adjustments to these coefficients would have the effect of reducing EMGME's pivotality to below the 10% threshold.[32]

4.21. In addition, SHT has used the UK assessment of the EU N-1 standard to show that there are no competition concerns from this exemption. The UK currently passes the EU N-1 standard, which considers the ability to meet demand in the scenario that the largest piece of infrastructure is lost. The Milford Haven to Felindre pipeline, which connects South Hook & Dragon to the rest of the NTS is considered the largest piece of UK infrastructure.

4.22. SHT considers that vertical integration is not a relevant factor in this application.

4.23. The competition criterion also requires us to have due regard to the efficient functioning of the pipeline system connected to the facility. SHT notes that they are working with National Grid to evaluate the work needed to reinforce the pipeline, via the pre-existing Planning and Advanced Reservation of Capacity Agreement (PARCA) framework. The

[30] See 'Guidelines for market investigations: Their role, procedures, assessment and remedies', Competition and Markets Authority. Pg. 87. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/284390/cc3_revised.pdf
[31] Pivotality, and the Ofgem Pivotality model, are further explained in Appendix 1 of this document.
[32] We consider that a market player with a 'pivotal volume' in excess of 10% will be generally deemed to have significant market power. See pg. 9 of this document.

applicant argues that, by following the PARCA framework, the exemption would not be detrimental to the efficient running of the pipeline system.

Ofgem's initial view

4.24. We are minded to consider that granting an exemption for the Incremental Capacity will not be detrimental to competition in any of the markets in which EMGME are active for the reasons set out below.

4.25. SHT's analysis concludes that there are no markets where the exemption would have a detrimental impact to competition. Our initial view is that we do not foresee competition concerns arising from this exemption in the GB wholesale or flexibility markets, over both the timeframe considered by SHT (2022 – 2033), and the timeframe covered by our own independent analysis (2023 – 2048). This is based on an assumption that all regassifed LNG is sold to EMGME, and that QP have no downstream interests in the EEA or GB gas markets.

4.26. As stated in section 3, we understand that the Sponsors now believe that Golden Pass will become operational in 2024, as opposed to 2023, as originally anticipated. The exemption, if granted, relating to the Incremental Capacity would begin from the date on which commercial operations begin (i.e. from the date on which LNG is delivered to the site from the Golden Pass export facility). Should Golden Pass become operational in 2024, the exemption would likely be active between 2024 – 2049. We note that our analysis would not extend to 2049. The findings from our analysis between 2023 – 2048, however, do not suggest that there are market trends which would raise competition concerns in 2049 arising from this exemption in the GB wholesale or flexibility markets context. In the interests of proportionality, we have not updated our analysis to include the year 2049.

4.27. The timeframe of SHT's competition analysis is significantly shorter than the 25 year (to 2048) exemption period sought by SHT. We recognise that it is difficult to provide projections of future market shares, given the high degree of uncertainty about market developments. However, longer-term considerations need to be taken into account before we can grant an exemption. Hence we have looked at the potential impact to the GB market over a longer period.

4.28. Over the 25 years of the exemption period sought, competitive conditions in the wholesale and flexibility markets (both in the UK and at a wider, European level) may well be different from those observed today, or 2023. Particularly, we consider that although the UK market currently has a large surplus in import infrastructure, and is well served by a number of different sources of supply, this situation might well be different in the future.

4.29. As a result, we have considered a number of different future scenarios to try to estimate the potential impact of an exemption. These scenarios are largely based on National Grid's 2018 update of the Future Energy Scenarios (FES) work stream.[33]

Global gas production

4.30. Ofgem notes that granting this exemption will facilitate the construction of a new source of supply to the global LNG market. In this way, competition in the global LNG market would be enhanced. Further, this exemption has the impact of opening up a new supply route between the US and GB, increasing the competitiveness of LNG supplies to GB and Europe.

4.31. We do not consider that the shares of the Project Sponsors, in the global gas production market, are relevant to the exemption application. The level of competition in the global gas supply market is outside of the remit of the Authority.

Regional gas supplies

4.32. We note SHT's analysis demonstrating EMGME's maximum predicted supply to the EEA as a percentage of demand. We consider that, even in the conservative scenario of 100% utilisation of both original and Incremental Capacity at SHT, the possible share of demand is low enough that we would expect it to have a negligible impact on competition. Further, we note that the increase of this share caused by 100% utilisation of the Incremental Capacity is approximately 1%.

4.33. The above leads us to conclude that the impact of granting SHT an exemption for the Incremental Capacity to competition in the EEA is not material.

[33] http://fes.nationalgrid.com/fes-document/fes-archives/

GB gas supplies

4.34. We have performed our own competition analysis, as well as undertaking an assessment of SHT's findings. We consider a wide-ranging review of the potential impacts to this market to be a prudent step in informing our minded-to position.

4.35. We note that in SHT's analysis, they have considered:

- Potential EMGME market shares, 2018 – 2033
- Potential impacts to HHI, based on latest available data (at the time of their analysis)
- Potential impacts to EMGME's pivotality, arising from Incremental Capacity at SHT

4.36. In our analysis, we have assessed the application against three indicators of market power. This is consistent with analysis undertaken by Ofgem for similar, recent applications:

- Market concentration, using sensitivities to consider potential future HHIs
- Market share, in wholesale supply & flexibility markets, 2023 – 2048
- Pivotality, 2023 – 2048[34]

4.37. For the purposes of all our analysis, we have considered that the Incremental Capacity is 100% utilised, and supplied to EMGME (as per the agreement between SHG and EMGME for the current exempt capacity). It is for this reason, that we base this assessment on EM's market share of the wholesale GB gas supply market.

<u>HHI</u>

4.38. We have estimated the HHI for total gas supplies to the GB wholesale market, with and without the exemption. By doing this, we are attempting to predict the impact that Incremental Capacity at South Hook might have on competition to the gas supply market.

[34] For example, Storengy UK Ltd's application for a Minor Facilities Exemption for Stublach gas storage phase 2 (https://www.ofgem.gov.uk/publications-and-updates/final-decision-%E2%80%93-storengy-uk-ltds-application-minor-facilities-exemption-stublach-gas-storage-phase-2)

4.39. The following are the key inputs for the HHI calculation:

- Company's market shares of gas supplied to the GB wholesale market

- Total gas supplied to GB

4.40. The market shares for three of the most recent four gas years (2014/15, 2016/17 and 2017/18) were available, and hence these were used to provide a range of potential future GB gas market shares.

4.41. Predicting future market share for different companies is unlikely to be accurate, hence we have considered sensitivities on gas supply to the GB market, and assumed the 2016/17 market shares (given that this year had a higher HHI than 2017/18). EM also had a greater share of gas supply to GB in 2016/17.

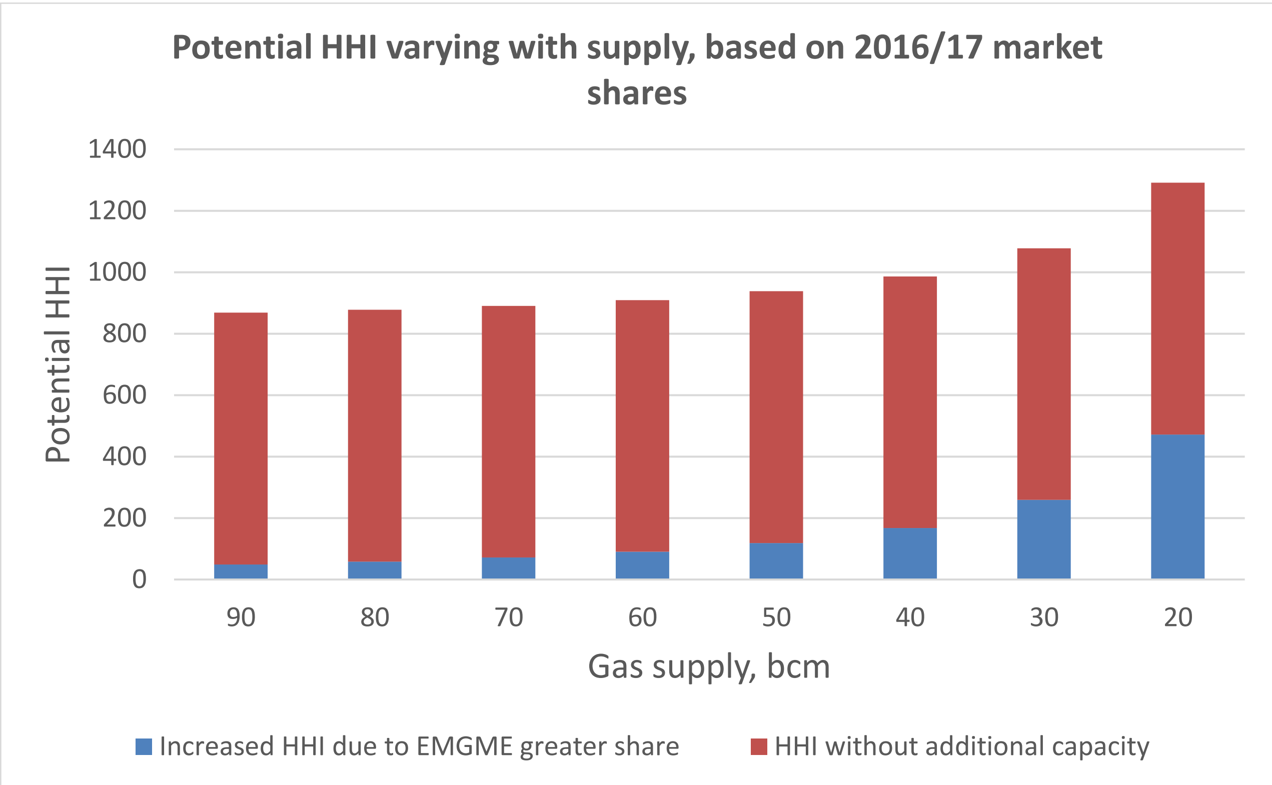

Figure 1(a): Graph: Ofgem assessment of the potential impacts to HHI should EMGME make use of the full Incremental Capacity at SHT, and all other market positions remain as per 2016/17 levels.

Potential HHI varying with supply, based on 2016/17 market shares

Gas Supply (bcm)	90	80	70	60	50	40	30	20
HHI without additional capacity	819	819	819	819	819	819	819	819
Increased HHI due to EMGME greater share	868	877	890	938	986	986	1078	1246

Figure 2(b): Data table: Ofgem assessment of the potential impacts to HHI should EMGME make use of the full Incremental Capacity at SHT, and all other market positions remain as per 2016/17 levels. This table reflects the information displayed in the graph above and is included to ensure this document is compliant with the relevant Web Content Accessibility Guidelines.

4.42. We have estimated the market share of the Incremental Capacity at SHT based on the assumed supply of gas to GB. As a result, the calculation of HHI is most conservative (i.e. higher) when low values of future gas supply are used, as this has the effect of increasing the relative market share of the Incremental Capacity.

4.43. Figure 1 shows that, under these assumptions, the HHI has the potential to increase above 1000 once gas supplies drop below approximately 40bcm/yr. According to National Grid's 2018 FES, the annual gas supply is only expected to fall to this level in one of the four scenarios assessed (Community Renewables, "CR") before the end of the potential exemption period. The CR scenario predicts that supply levels will drop below 40 bcm/yr in 2043.

4.44. We note that the analysis presented here predicts that there is potential for the HHI of the GB gas supply market to increase above the CMA threshold, should SHT increase the capacity of their terminal. However, we also note that this analysis is based on some conservative assumptions. For example, the extra capacity at SHT is assumed to be 100% utilised, and only EMGME's market share is increased as a result. In our view, both of these are unlikely to be realised, based on the fact that we estimate the maximum average annual utilisation of GB LNG terminals over the past three years to be 22%, in 2016.[35]

[35] Source: National Statistics. Energy Trends: UK gas. Section 4.4 https://www.gov.uk/government/statistics/gas-section-4-energy-trends

4.45. As a result, our analysis has led us to conclude that granting an exemption for the Incremental Capacity at South Hook is unlikely to result in a significant impact on market concentration.

Market share

4.46. Flexibility considers the ability of a supply source to respond to changes in market fundamentals. In previous exemptions for both LNG and storage facilities, we considered definitions of the flexibility market to assess potential competition concerns in the market for flexible supply capacity, as these sources compete to provide flexible supply to the market. We have also considered how the Incremental Capacity could affect market share in the wholesale gas supply market in GB.

4.47. Our analysis is based on similar work, which was carried out in 2014 to assess Minor Facility Exemption applications for the Hornsea and Stublach gas storage facilities.[36]

4.48. We use various definitions of the flexibility market (the proportion of the supply sources which can be considered to respond to price signals, and periods of tight supply / demand), to assess EMGME's ability to negatively impact the market.

4.49. Key inputs:

- Flexibility market definitions.
- EMGME market share. All gas is assumed to be sold to EMGME, and available 100% of the time (current exempt SHT capacity, and all Incremental Capacity).
- Maximum supply capacities, per source
- FES Community Renewables scenario (lowest total peak supply, hence highest predicted market share, as EMGME's LNG market share is maximised)

[36] https://www.ofgem.gov.uk/sites/default/files/docs/2015/02/hornsea_mfe_-_consultation_feb_15_0.pdf

- SHT Incremental Capacity comes online in 2023 (so assumed from start of 2023/24 gas year, or 2023 calendar year, see Annex 13 – Market Test of SHT application).

4.50. We have set out three flexibility market scenarios. In each of the scenarios the gas supply from the various facilities changes with the exception of LNG supply which is assumed to be 100% in all three scenarios. This means that in times of tight supply, we assume LNG facilities to be able to react and send-out their full capacity. This is an unrealistically conservative assumption as we deem it unlikely that all three GB LNG terminals will be able to send-out at their maximum capacity at the same time. However, this allows us to capture the worst possible case market share that we could expect EMGME to yield, as a result of an expansion at SHT.

4.51. Flexibility market 3 is the most conservative scenario due to lower supply from supply from most sources. In the paragraphs below, the figures provided for each flexibility market scenario in per cent equates to the gas supply capacity of that facility flowing to the GB market assumed in each of the three flexibility market scenarios.

4.51.1. Flexibility market 1: Medium Range Storage (supplying at) 100% of (its capacity) + UKCS flexibility 100% + IUK 100% + BBL 75% + LNG 100% + Norway 30% + UKCS at 0%

4.51.2. Flexibility market 2: Medium Range Storage 75% + UKCS flexibility 100% + IUK 75% + BBL 50% + LNG 100% + Norway 15% + UKCS 0%

4.51.3. Flexibility market 3: Medium Range Storage 50% + UKCS flexibility 100% + IUK 50% + BBL 25% + LNG 100%+ Norway 0% + UKCS 0%

4.52. Using the market definitions and our assumptions above, we find that the maximum potential increase in flexibility market share for EMGME as a result of accessing increased capacity at SHT is 4%.

4.53. This is based on a very conservative definition of the flexibility market (definition 3) whereby only 50% of gas in storage is supplied to the GB market, there is limited gas supply from the IUK and BBL interconnectors, no gas is being supplied from the gas fields in Norway and no gas is supplied by the UKCS. This is a highly unlikely and, therefore a very conservative, scenario. Using a less conservative definition (flexibility market2), we find that the maximum potential increase in flexibility market share is 3.5%.

4.54. Having considered various sensitivities around the inputs for this calculation, we consider that granting an exemption to SHT would not be detrimental to competition in the GB flexibility, or wholesale supply market. This is our view using the conservative assumptions listed above. As such, this provides reassurance that there is even less likelihood of EMGME possessing market power in the future.

Pivotality

4.55. We published a gas pivotality model in 2011. It is explained in Appendix 4 of our consultation on Storengy's application for a Minor Facility Exemption (MFE), 2013.

4.56. We have updated the pivotality model from the version published in 2011, to perform our own assessment of the potential impact to EMGME's ability to exhibit market power, given a 25-year exemption for Incremental Capacity at SHT.

4.57. In order to do this, we have had to make various assumptions about future gas demand, future gas supply capacity, EMGME market share and the availability of different sources of gas supply. As a result, we consider that the results found, for years closer to the present, are more accurate than looking towards the end of the potential exemption period.

4.58. The key conclusion from our analysis is that under normal circumstances it is difficult to consider EMGME 'pivotal' to meeting GB demand. We find this to be the case both before and after the proposed expansion of SHT, where the same FES scenario is used to assume both the supply and demand.

4.59. This differs from the conclusion reached by SHT, in its pivotality analysis. We consider our conclusion to be a more likely prediction of future pivotality as it is based on updated assumptions regarding supply and demand.

4.60. In summary, we have reviewed the potential impact of granting an exemption for the Incremental Capacity at SHT to competition in the EEA's wholesale gas market, and the GB gas wholesale market. We are minded-to conclude that any impacts on these markets, from granting an exemption, will be negligible.

4.61. We further note that the EC Guidance advises that the possible negative effects of the exemption should be considered, under section 19C(7)(e) of the Gas Act, as well as the impacts to competition. Paragraph 2.15 provides a summary of our view on the impact a possible exemption could have on the interests of the EU and other MS in accordance with the principle of energy solidarity. In our view, the granting of an exemption for the Incremental Capacity at SHT would not harm the functioning of the EU's internal gas market, or the transmission system to which the infrastructure is connected. We are further reassured that applicable secondary trading arrangements will be in place for the Incremental Capacity, and that, as the National Regulatory Authority (NRA), we will monitor anti-hoarding mechanisms and ensure that shippers have access to a sufficiently transparent secondary market.

4.62. We note the ongoing PARCA application related to the expansion of SHT. We agree that the PARCA process will reduce the likelihood of a detrimental impact to the efficient running of the pipeline system.

4.63. As a result of our assessments related to section 19C(7)(e) of the Gas Act, we are minded to consider that this condition is met.

5. Relevant subsections of section 19DB of the Gas Act – SHT's submission and our initial views

Section summary

This section provides an overview of SHT's views on how they intend to allocate capacity, pursuant to section 19DB of the Gas Act. We also give our initial views on why we consider SHT to have satisfied the relevant requirements.

Questions

Question 1: Do you agree that SHT has appropriate secondary trading mechanisms in place, to ensure that unused capacity is used as efficiently as possible?

Question 2: Do you believe there to be any unnecessary barriers to entry for use of SHT capacity, via secondary mechanisms?

Question 3: Considering the application for an exemption from rTPA for the Incremental Capacity at the SHT and our analysis as a whole, is there any other factor you believe must be considered before we finalise our decision?

Section 19DB(2)[37]

5.1. This subsection specifies that the application must specify the criteria that will be used to determine who is to be granted rights to use the infrastructure to which the application relates and the way in which those rights may be exercised.

5.2. In their application, SHT suggests that the commercial structure for primary allocation of the Incremental Capacity will be as per the current arrangement between SHT and SHG

[37] The application must specify the criteria that will be used to determine--
(a) who is to be granted rights to use the facility, or the part of the capacity of the facility, to which the application relates (the "exempt infrastructure"); and
(b) the way in which those rights may be exercised, (the "capacity allocation mechanism").

(see 'Annex 2 - Potential Commercial Structures' of their application). The capacity allocation mechanisms in use at the terminal are also explained in their application (see 'Annex 3 – Primary and Secondary Capacity Allocation Mechanisms' of their application).

5.3. Therefore, our initial view is that we consider that the requirements of Section 19DB(2)are satisfied.

Section 19DB(3)[38]

5.4. Section 19 DB(3) of the Gas Act specifies that the Authority must not give an exemption unless it has approved the capacity allocation mechanism. Such approval can only be given if the three conditions set out in subsections (5), (6) and (7) of Section 19DB have been satisfied. The capacity allocation mechanism in use at SHT was approved as part of the original exemption. Our understanding is that the Incremental Capacity is to be allocated in the same way both to primary rights holders and in secondary trading. As such, and as explained more fully below, we are minded to approve the capacity allocation mechanism on the basis that section 19DB subsections (5), (6) and (7) of the Gas Act are satisfied.

Section 19DB(4)[39]

5.5. This subsection of the Gas Act sets out the conditions that must be satisfied before the capacity allocation mechanism is approved. The approval of the capacity allocation mechanism is necessary before an exemption can be granted. The three conditions are detailed in section 19DB subsections (5), (6) and (7) of the Gas Act, respectively. They are dealt with below.

[38] The Authority must not give an exemption under section 19A or 19C of the Gas Act in response to the application unless it has-
(a) approved the capacity allocation mechanism specified in the application; or
(b) approved the mechanism on condition that certain modifications are made to it.
[39] The Authority may only approve the capacity allocation mechanism under subsection (3)(a) of the Gas Act if it considers that the mechanism meets the following three conditions.

Section 19DB(5)[40]

5.6. The first condition is that interested parties must be able to register an interest in using the exempt infrastructure. The Commission Staff Working paper on exemptions states that Project promoters are required to test market demand through open seasons and other equivalent procedures, before they can obtain an exemption for a new piece of infrastructure or a capacity increase at an existing infrastructure. This is to ensure that the size of the proposed infrastructure meets market participants' needs and that capacity is allocated in a fair, transparent and non-discriminatory way. A process for testing market demand also mitigates the potential foreclosure and increased barriers to entry which might arise from the allocation of capacity on a long-term basis.

5.7. We note that SHT brought the proposed expansion to the attention of industry via a market test, allowing interested parties to express their interest for a period of 28 days. We consider that this is sufficient to meet the condition in subsection (5).

Section 19DB(6)[41] - (7)[42]

5.8. The conditions are that any unused capacity must be made available to other users or potential users and that the capacity allocation mechanism must not prevent, or be capable of being used to prevent, secondary trading of capacity.

SHT's view

5.9. SHT states in its application that the three levels of anti-hoarding measures, already in place at the terminal for the original capacity, will also apply to the Incremental Capacity. These measures are: by agreement with the Base User, transfer of South Hook Bundles

[40] The first condition is that before a right to use the exempt infrastructure is granted to the owner of the facility or to any other person--
(a) the intention to grant a right to use the exempt infrastructure must be published in a way that the Authority considers appropriate for the purpose of bringing it to the attention of persons likely to be interested in using the infrastructure; and
(b) such persons must be able to register an interest in using the exempt infrastructure.

[41] The second condition is that the mechanism must require that any unused capacity in the exempt infrastructure be made available to other users or potential users.

[42] The third condition is that the mechanism must not prevent, and must not be capable of being used to prevent, subsequent trading of rights to use the exempt infrastructure.

(SHBs) and UIOLI. In addition, SHT also sells interruptible capacity on to interested parties from time to time. These measures are set out in detail below.

5.10. By agreement with the Base User:

5.10.1. SHG, as the Base User, acquired all firm primary capacity rights to the original exempt capacity at SHT. It is envisaged that a similar arrangement will be made for the Incremental Capacity.

5.10.2. SHG offers any spare capacity, resulting from scheduling inefficiencies, to Additional Users. Capacity is sold in the form of a SHB. A SHB provides users with: a berthing slot, firm redelivery capacity and LNG storage space for a defined period (during which the additional user must nominate redelivery). In order to make use of SHBs, market participants become an 'Additional User' of the facility.

5.10.3. SHG offers toll processing services. This takes the form of a bilateral Master Regasification & Gas Delivery Agreement (MRA). It includes secondary terminal capacity, and allows for simplified access to the terminal, as it doesn't require a third party to become an Additional User.

5.11. Via SHB transfer to other Additional Users:

5.11.1. Once created, a SHB can be sold between additional users.

5.12. Via a SHT auction, under a UIOLI regime.

5.12.1. If SHG is not using a berthing slot, then they release it back to SHT 14 days ahead of the slot. SHT carries out an auction to offer the slot to the market. A UIOLI slot includes: a berthing slot, storage capacity and gas redelivery for a set period of time following the scheduled delivery slot.

Ofgem's initial view

5.13. We note that secondary trading and UIOLI arrangements are infrequently used at LNG terminals in the GB. Current LNG import capacity in GB outstrips requirements, so their infrequent use is not necessarily due to a lack of effectiveness of the anti-hoarding arrangements. Other mechanisms for accessing unused capacity, such as secondary trading of cargoes, are more prevalent and effective. While we welcome the secondary trading of LNG cargoes, this does not release LNG terminals from their obligation to provide third party access to unused primary capacity at the terminal.

5.14. We are not aware of any concerns that have been raised regarding the existing anti-hoarding arrangements at SHT. As such, we are minded to consider that the conditions under 19DB(6) – (7) of the Gas Act are met.

Appendices

Index

Appendix 1 – Draft Exemption Order

GAS ACT 1986

SECTION 19C

EXEMPTION

Pursuant to section 19C(5) of the Gas Act 1986 (the Act), the Gas and Electricity Markets Authority hereby gives to South Hook LNG Terminal Company Ltd[43], as 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 Dale Road, Herbrandston, Milford Haven, Pembrokeshire, SA73 3SU subject the attached Schedule.

Tom Corcut
Authorised in that behalf by the Gas and Electricity Markets Authority
Dated [DAY MONTH YEAR]

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[43]A Company registered in England and Wales with registration no. 04982132

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 located at Dale Road, Herbrandston, Milford Haven, Pembrokeshire, SA73 3SU
"facility owner"	means South Hook LNG Terminal Company Ltd in its capacity as owner of the facility
"facility operator"	means South Hook 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 exemption relates to the incremental capacity at South Hook LNG Terminal Company Ltd import facility comprising 5.3 bcm/yr (the "Incremental Capacity").

C. Period

Subject to Section E below, and pursuant to section 19C(3)(a) of the Act, this exemption will cease to have effect in respect of the Incremental Capacity of the facility, 25 years from the date that commercial operation commences in respect of the Incremental Capacity.

D. Conditions

Pursuant to section 19C(3) 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 the exemption is and remains accurate in all material respects.

2. The facility owner notifies the Authority within ten days of the Incremental Capacity of the facility commencing commercial operations.

3. That the intended agreements described in a Letter of Intent from South Hook Gas Company LTD to Ocean LNG Limited, dated 11 July 2019 (and shared with the Authority), representing the Golden Pass value chain, or such other agreements as the Authority considers to be equivalent, are executed.

4. That the export LNG terminal currently known as 'Golden Pass', under consideration for construction in the US, continues to be licensed to export LNG to the facility throughout the period of this exemption.

5. The facility owner has effective anti-hoarding measures in place approved by the Authority. Such measures shall be subject to periodic review and approval by the Authority.

6. 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 may be necessary, for the purpose of:
   (a) performing the function 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.

7. 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 –
   (a) at such times, in such form and such manner; and
   (b) in respect of such periods, as may be so specified or described.

8. 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 pipeline 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

9. 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.

10. 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 36(9) of Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009).

11. 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.

E. Revocation

Pursuant to section 19 CA(5) 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 36(9) of Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009) 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 36(9) of Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009) that the Authority amend the decision to grant this exemption and the facility owner does not agree (under paragraph D10 above) for this exemption to be amended in the manner so requested by the European Commission.

3. The Authority must revoke this exemption if the construction works required at the facility for the Incremental Capacity have not been started within 2 years from the date of this exemption or if commercial operations in respect of the Incremental Capacity at South Hook have not commenced within 5 years of the date of this exemption decision in accordance with Section 19CA(3) of the Act.

4. 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 section 19C (7)(a), (c), (d) or (e) of the Act are met with respect to the facility as the result of any action or omission of the facility owner, facility operator or throughputter;
      ii. any of the conditions in paragraphs D1, D2, D3, D4 and D5 above is not (or does not continue to be) fulfilled, and remains outstanding beyond the period specified in the notice;
      iii. 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;
      iv. the facility owner has an administration order under section 8 of the Insolvency Act 1986 made in relation to it;
      v. the facility owner is found to be in breach of the Competition Act 1998; or
      vi. 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 D6 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 D7 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.

Appendix 2 – Article 194 of the Treaty of the Functioning of the European Union

1. In the context of the establishment and functioning of the internal market and with regard for the need to preserve and improve the environment, Union policy on energy shall aim, in a spirit of solidarity between Member States, to:

(a) ensure the functioning of the energy market;

(b) ensure security of energy supply in the Union;

(c) promote energy efficiency and energy saving and the development of new and renewable forms of energy; and

(d) promote the interconnection of energy networks.

2. Without prejudice to the application of other provisions of the Treaties, the European Parliament and the Council, acting in accordance with the ordinary legislative procedure, shall establish the measures necessary to achieve the objectives in paragraph 1. Such measures shall be adopted after consultation of the Economic and Social Committee and the Committee of the Regions.

Such measures shall not affect a Member State's right to determine the conditions for exploiting its energy resources, its choice between different energy sources and the general structure of its energy supply, without prejudice to Article 192(2)(c).

3. By way of derogation from paragraph 2, the Council, acting in accordance with a special legislative procedure, shall unanimously and after consulting the European Parliament, establish the measures referred to therein when they are primarily of a fiscal nature.

Appendix 3 – Privacy Notice on Consultations

Personal data

The following explains your rights and gives you the information you are entitled to under the General Data Protection Regulation (GDPR).

Note that this section only refers to your personal data (your name address and anything that could be used to identify you personally) not the content of your response to the consultation.

1. The identity of the controller and contact details of our Data Protection Officer

The Gas and Electricity Markets Authority is the controller, (for ease of reference, "Ofgem"). The Data Protection Officer can be contacted at dpo@ofgem.gov.uk

2. Why we are collecting your personal data

Your personal data is being collected as an essential part of the consultation process, so that we can contact you regarding your response and for statistical purposes. We may also use it to contact you about related matters.

3. Our legal basis for processing your personal data

As a public authority, the GDPR makes provision for Ofgem to process personal data as necessary for the effective performance of a task carried out in the public interest. i.e. a consultation.

3. With whom we will be sharing your personal data

(Include here all organisations outside Ofgem who will be given all or some of the data. There is no need to include organisations that will only receive anonymised data. If different organisations see different set of data then make this clear. Be a specific as possible.)

4. For how long we will keep your personal data, or criteria used to determine the retention period.

Your personal data will be held for ***(be as clear as possible but allow room for changes to programmes or policy. It is acceptable to give a relative time e.g. 'six months after the project is closed')***

5. Your rights

The data we are collecting is your personal data, and you have considerable say over what happens to it. You have the right to:

- know how we use your personal data
- access your personal data
- have personal data corrected if it is inaccurate or incomplete
- ask us to delete personal data when we no longer need it
- ask us to restrict how we process your data
- get your data from us and re-use it across other services
- object to certain ways we use your data
- be safeguarded against risks where decisions based on your data are taken entirely automatically
- tell us if we can share your information with 3rd parties
- tell us your preferred frequency, content and format of our communications with you
- to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law. You can contact the ICO at https://ico.org.uk/, or telephone 0303 123 1113.

6. Your personal data will not be sent overseas (Note that this cannot be claimed if using Survey Monkey for the consultation as their servers are in the US. In that case use "the Data you provide directly will be stored by Survey Monkey on their servers in the US. We have taken all necessary precautions to ensure that your rights in term of data protection will not be compromised by this".

7. Your personal data will not be used for any automated decision making.

8. Your personal data will be stored in a secure government IT system. (If using a third party system such as Survey Monkey to gather the data, you will need to state clearly at which point the data will be moved from there to our internal systems.)

9. More information For more information on how Ofgem processes your data, click on the link to our "Ofgem privacy promise".