Summary of the third meeting of the Working Group on the regulation of LNG terminals in France

THE REGULATION OF EXISTING LNG TERMINALS

29 January 2008

A. The concept of a surplus capacity margin for gas imports (**Presentation by Pierre-Marie Abadie**)

The opening of the European gas market creates a new context.
The national market with its monopolies and centralised planning is gradually being replaced by a deregulated market made up of many players.

To cope with any failures, centralised planning for security of supply in gas is being replaced by prudential rules and the requirement for a reserve to cover the portfolio of sales. From now on, transmission system operators must be able to offer, in line with demand from the market, capacity compatible with the deployment of the supply strategies of the new suppliers.

The Group believes that it would be desirable for these measures (definition of the failure of a supplier and prudential rules) to be harmonised at European level.

B. The European dimension of LNG terminal projects in France (**Presentation by Pierre-Marie Abadie**)

Today, LNG terminals are in competition in certain zones, but not at European level. The strategic interest of the LNG terminals militates for the development of these infrastructures on the national territory.

To a certain extent, Northern Europe is a liquid market in which the French LNG terminals in the North zone (Montoir and the future terminals in Dunkerque and Le Havre) will be competing with other European terminals (particularly Zeebrugge).
The southwest of France will eventually benefit from investment in the gas pipelines linking France with Spain. The future terminal at Le Verdon would then be in competition with the Spanish terminals.
However, by 2015, the horizon chosen for the Group's analyses, the South zone of France will probably not be connected in an optimal way with the North zone.
The Group considers that the presence on the French market of a single gas zone would improve significantly his liquidity. As a consequence, the Group would like the CRE to launch a study of the investment needed to achieve this, and therefore to make a suitable North/South connection.
The study should take account of:
- the needs of the market;
- the flows needed for the fluid operation of the market;
- the benefits expected of a single zone for gas.

C. Pricing visibility (**Presentation by Jean-François Corallo**)

The Group unanimously recognises that long-term pricing visibility encourages investment by operators and commitment from subscribers.
The dialogue between investors and subscribers also needs to be strengthened. In a regulated system, this dialogue is facilitated by the regulator and is based on tariffs.
In an exempt system, prices and marketplace rules replace tariffs.

With this in mind, the majority of the Group agrees to:

1) take a **view of tariffs that runs over a number of years**: a period of between 15 and 20 years depending on the operators' payback (debt repayment) time;

2) decide for the long term on **the methodology** for calculating tariffs. This method will determine how the risks are shared between the operator and the subscribers. The type of risks needs to be defined in advance, as well as how each risk will be dealt with. For example:
   - interest rate: the current practise is a system based on bonus, taking into account the risks and promoting the investments. The Group believes this should be fixed over the period being considered, with the operator taking on the risk of interest rate changes and taking on financial cover for these if it wishes;
   - the level of subscription of the terminal: the Group recommends taking account of the levels of subscription observed in the markets when calculating the tariff, implementing a system of sharing the additional income from higher subscription levels. Most of this new income would be redistributed to the subscribers and the remainder retained by the operator to give the operator an incentive to find new customers;
   - investment:
     1. if costs increase because of poor management by the operator, this additional expense would be borne entirely by the operator;
     2. if there are clearly identified external causes (for example, additional costs associated with a review of the maximum seismicity at Fos Cavaou), these additional costs would be included in the Regulated Assets Base;
     3. additional costs associated with an increase in the cost of materials and labour during construction would only be built into the RAB after a percentage had been neutralised;
     4. clauses on tariff revision and additional cost sharing should be provided.
   - tariff revision clause: 4 to 5 years seems to be an appropriate period, with precise definition of the items taken into account;
   - productivity incentive by taking account of falls in operating expenditure;
   - investment depreciation period: this period should be such it is incentive for the investor, but not as it leads to an important increasing of the tariff, for the terminal to be competitive regarding the existing terminals. The Group recommends an investment depreciation period between the payback time and the economic life time of the infrastructures.

3) define a very minor stable proportion (e.g. between 10 to 15%) of capacity to be dedicated to **short-term contracts**, the duration of which should be specified (period of 3 to 4 years). The Group notes that grouping several shippers together in a consortium (like at Fos Cavaou) seems to constitute a good solution that gives smaller shippers access to the terminal without making it more complex to manage.

D. The "Use it or lose it" or, more accurately, "Use it, sell it or lose it" mechanism

This mechanism is designed to encourage optimal use of the infrastructure, giving shippers who have not signed up to long-term contracts the possibility of accessing the infrastructure while this capacity is physically available, but keeping the capacity in the hands of the primary holder.

The Group agrees that this mechanism is complex, seen from the point of view of the market, and that it is right that it should play a part in the **maximum optimisation of the infrastructure.**

The procedure used should give shippers an incentive to be virtuous, without actually making the terminal less attractive, particularly in view of the fact that it is possible to choose the destination of the gas, something very specific to LNG compared with the gas pipelines.
No European examples (Zeebrugge, Isle of Grain) seem to have achieved the results hoped for so far.

Two mechanisms are identifiable:

- an ex ante mechanism with the implementation of a penalty or a take back of the capacities to the shippers practising capacity hoarding;
- an post ante mechanism with the duty to release on the secondary market the non-utilised capacities. The notice period is a sensitive parameter and must be adapted to the LNG logistics chain, which is more complex than that of the gas pipelines. Taking into account the geographic position of France, close to the producer countries, the Group believes that a period of two weeks to one month would be best.

Taking account of the context, the Group believes that the methods of implementing this mechanism will have to be flexible and able to be revised in the light of experience.

The Group points out that in a fluid and transparent market with surplus capacity, this mechanism should no longer be necessary.

The Group believes that a high degree of transparency regarding the data for the terminals (subscriptions, boat arrivals and available storage, for example) is necessary for this mechanism to be able to function properly.