Summary of the 4th meeting of the Working Group on the regulation of LNG terminals in France

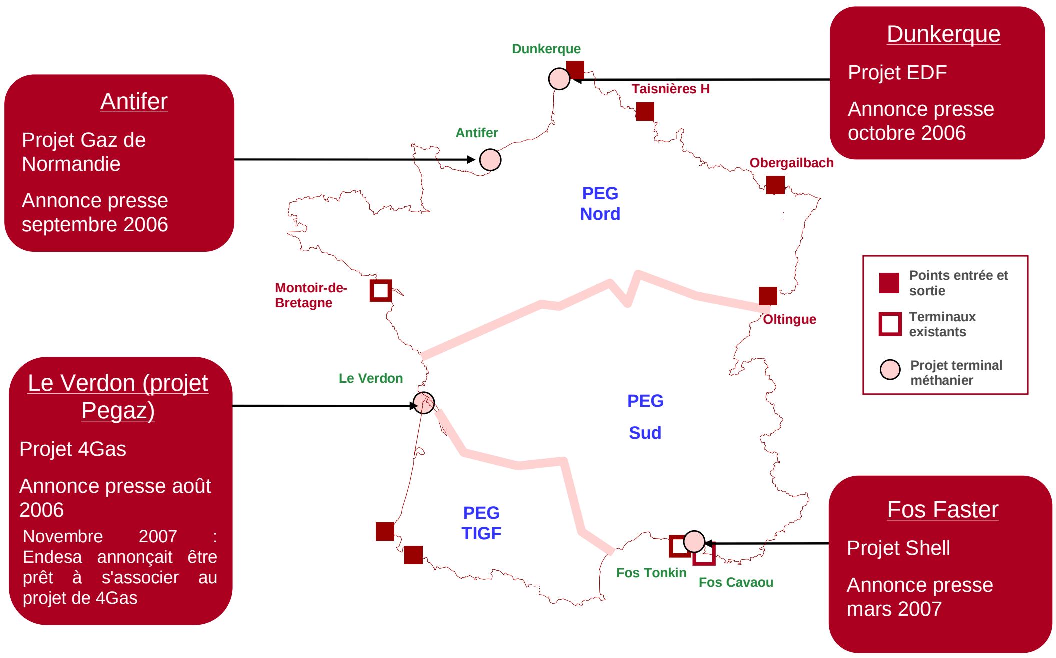
THE PROJECTS OF NEW LNG TERMINALS IN FRANCE

29 February 2008

A. Projects for new LNG terminals in France (Presentation by François MORIN)

To date there are four projects for new LNG terminals in France:

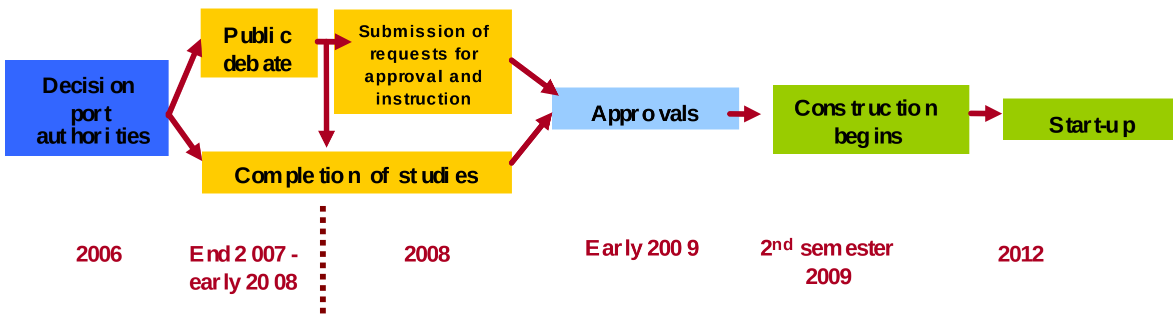
- Dunkirk: this project is sustained by Dunkerque LNG, a subsidiary of EDF, for a capacity of 6-12 Gm^3/yr, with start-up planned for 2012;
- Antifer: this project is backed by Gaz de Normandie, with Poweo sharing 34 %, E.ON Ruhrgas 24.5%, Verbund 24.5% and CIM 17%, for a capacity of 9 Gm^3/yr and start-up planned for 2012 ;
- Verdon: this project is managed by 4Gas, a Dutch company founded in 2005 from the acquisition of the LNG assets of Petroplus, whose shareholders are Carlyle and Riverstone, specialists in private investment funds, for a capacity of 6 to 9 Gm^3/yr, with start-up planned for 2012;
- Fos: this project, called Fos Faster, is managed by Shell, for a capacity of 8Gm^3/yr, and start-up planned for 2015.



The sum total of existing and planned regasification capacity indicates a maximum global capacity of 74 Gm^3/yr in 2014 (i.e. 30% of European LNG requirements in 2020). It is foreseen that probably not all the projects will be commissioned.

Current situation		
Fos Tonkin	5,5	
Montoir	10	
Fos Cavaou	8,25	
Total 1	23,75 Gm³/an	
Maximum capacities at end 2012	1^{srt} scenario	2nd scenario
Montoir (if extension 1)	+ 2,5	
Antifer	9	
Dunkirk	6	+ 6
Le Verdon	9	+ 6
Total 2	+ 26,5 Gm³/an	+ 12 Gm³/an
Maximum capacities at end 2014		
Montoir (if extension 2)	+ 4	
Fos Faster	8	
Total 3	+ 12 Gm³/an	
Maximum capacities at end 2014	**74,25 Gm³/an**	
European LNG supplies in 2013 (AIE forecast)	**140 Gm³/an**	
European LNG supplies in 2015 (Total forecast)	**155 Gm³/an**	
European LNG supplies in 2020 (Andy Flower 2007 forecast)	**220 Gm³/an**	

From the provisional schedule presented by the contractors, it may be expected that commissioning for these projects will be spread over 2012:



B. <u>Public debate</u> (Presentation by François MORIN)

Under the law dated 27 the February 2002, and in accordance with the decree dated 22nd October 2002, any creation or extension of port infrastructures must be referred to the CNDP (National public debate commission) if the cost of the project exceeds €150M or if the surface area is greater than 200 hectares (approx 494 acres).
When the CNDP decides to organise itself public debate, it sets up a special commission (CPDP) to which the contractor presents a dossier for the debate (*cf.* http://www.debatpublic.fr/index.html)

Public debate concerning the Antifer, Dunkirk and Verdon projects took place between September and December 2007 and concerned projects underwritten by private investors for the first time in the history of public debate in France.

It should be noted that one of the principal difficulties in public debate derives from the procedure itself, which places the debate very much in advance of the project, at a point when the technical and environmental studies have not been completed and the underwriters of the project may not have all the answers to questions which may be asked by the public, which tends to crystallize the fears of the local population.

The themes developed were:

- the public's failure to understand the need for increasing consumption of natural gas, which is a fossil energy emitting greenhouse gases, in a context where trends are rather towards renewable energy sources;
- the principle of the positive effect of competition on price reductions, which is not accepted by all participants. In this context, it is difficult for the public to recognise the need to develop LNG terminals in competition with each other;
- safety and industrial risks;
- protection of biodiversity;
- tourism;
- visual impact of these infrastructures.

In their report, the CPDPs highlighted a strong local opposition, with a variable intensity in function of the project, and expressed by local associations and sometimes by elected representatives.
This feature makes the situation very similar to local opposition seen in the USA, where, however, the *"nimby"* syndrome (*"Not in my back yard"*) and the fear affecting the industrial sites, are much more important.

The CPDPs reports can be found above the following links:

- Dunkirk: http://www.debatpublic-dunkerquegaz.org/documents/cr-bilan.html ;
- Antifer: http://www.debatpublic-antifer.org/documents/compte-rendu-du-debat.html;
- le Verdon: http://www.debatpublic-terminal-leverdon.org/actualite/compte-rendu-debat.html.

C. Regulated third party access (rTPA) exemption

Five criteria imposed by European directive 2003/55/CE must be satisfied to obtain exemption:

- the investment must reinforce competition for gas supplies and improve supply security;
- the level of risk associated with the investment must be such that the investment will not be made if an exemption is not granted;
- the infrastructure must be owned by a natural person or a legal entity which is separate, at least with regard to its legal status, from the managers of the systems within which it will be built;
- taxes are paid by the users of the infrastructures concerned;
- the exemption does not infringe competition or the proper functioning of the internal gas market, nor the efficiency of the regulated network to which the infrastructure is connected.

For LNG terminals, exemption for third party access is particularly suitable for encouraging investment, so that investors have a lower risk to support.

Two options are available for financing a LNG terminal project:

- *"corporate"* financing;
- project financing.

It is essential that the second option is open to new players in competition with the incumbent operators.
For project financing, banks require the investment by long term contracts. If this cover were only partial, any shippers who had made long term reservations would have to bear the whole of the related costs.

Furthermore, the tariff negotiated between the parties is adapted to the decision process for the financing of a project, because its price is determined when the regasification contract is signed, and is set for the long term. This stability is a key factor both for investors and banks.

The recommendation of the majority of the Group is to lead a case study of the exemption scope (tariff and capacity). This analysis should take into account the interest for the market of a limitation of this scope (available capacities on short term) compare to, on one hand the technical difficulty to have an extra terminal user, and on the other hand the potential increase of the investment amount.
Provided this analysis, it would be relevant to:

- not reserve systematically capacities dedicated to short term contracts;
- not limit systematically the scope of the exemption (tariff and capacity) in order to allow the investor to have complete control over the risk;
- let the investors assess the market, the capacities allocation having to be transparent.

In all cases:

- the tariffs of exempted LNG terminals has to be published;
- in order to favour the development of new LNG terminals, investors must have priority for access to the capacities of the installations they have developed, in conditions which allow the market to function correctly;
- however, the Group recommends against any supplier having access to more than 2/3 of the capacity of a new LNG terminal in France, in order to favour a diversity of the market players;
- the rules of transparency and the *"Use it or lose it"* mechanisms apply in the same way to exempted terminals as to regulated terminals, with the possibility of ex post monitoring by the regulator. Discouraging penalties have to be applied to prevent hoarding behaviour;
- a secondary market mechanism has to be implemented. An ex post review could be monitored by the regulator;
- the investor in LNG exempted terminal has to consider favourably the possibility of an expansion of its terminal, in regard of the market needs and if it is possible technically and financially;
- a periodic review of the conditions of the exemption is necessary, according to the market evolution.

The Group notes that from the legal point of view, nothing prevents an incumbent operator to request exemption for a new infrastructure. Nonetheless, this must depend at the very least upon the hiving-off of the infrastructures and satisfactory rules of governance (managerial separation).

The grant of an exemption for the extension of an existing regulated terminal is possible. This exemption depends on the respect of certain rules of governance and on the condition that this extension will lead to a decrease of the incumbents market share.
Cohabitation on the same terminal of the two regimes has to be analysed by the national regulator, in order to avoid unfair competition between the regulated and exempted capacities.

Moreover, ERGEG is working on a guideline of good practices for the article 22 application.

D. Transparency

Transparency of data regarding access to the infrastructure also plays a key role.

Currently, information published by operators of existing French terminals complies with the ERGEG guidelines for good practice: technical capacity, reserved capacity, observed flows, unloading slots available, etc.
The transparency of these publications is now considered satisfactory by the Group.

On the other hand, this transparency needs to be applied identically on all future LNG terminals.

E. A European price framework (Presentation by Luc POYER)

To allow the European market's attractiveness to producing countries compared with the Asian and American markets, the Group wishes a greater liquidity between the gas markets, leading to the establishment of a European price framework.

The following conditions are necessary for this liquidity:

- a reduced number of balancing zones to allow a better interconnection between different zones and consequently the emergence of market prices;
- players who are big enough to play the role of *"market maker*";
- trading sites (gas exchanges);
- homogenous gas quality and rules of nomination and balancing between countries;

F. Conditions for competition (Presentation by François LEVEQUE and Luc POYER)

The regulation is not supposed to support a regime more than the other one. But in both cases, the regulator has to foster the investment.
In France, the LNG terminals are regulated and this situation will last at least until 2012.
Tomorrow, regulated terminals could cohabit with exempted terminals, leading to prices adjustment.

When competition between regulated and exempt terminals becomes effective, it will result in the supply of differentiated services of which price will be one of the key elements.
In view of the increasing number of terminals in Europe, they will be in competition in their zones of influence.

Until new capacities are available (2012), the regasification capacity proposed by terminals will be a constraint for a given period.
In the short term this can create situations of "shortage" which will displace demand for reservation capacity to other countries. In the medium term, better balance between supply and demand for capacity will lead to an adjustment of exempt terminal prices compared to those of regulated terminals.