

EUROGAS RESPONSE TO THE ERGEG PUBLIC CONSULTATION ON THE PROPOSED GUIDELINES OF GOOD TPA PRACTICE FOR LNG SYSTEM OPERATORS (GGPLNG)

INTRODUCTION

1. Members of the Eurogas LNG Task Force have a substantial interest in the regulatory framework for LNG supply and regasification facilities as LNG is becoming more critical to European energy supplies and competition in the internal market. Some Eurogas members have extensive experience in many parts of the LNG value chain, while some Eurogas members are now just entering the LNG import business. Also, certain Member States are now addressing the appropriate regulatory framework for this business for the first time. Accordingly, the Eurogas comments reflect extensive experience in the industry as well as concerns raised by new entrants.

GENERAL OBSERVATIONS

2. The GGPLNG proposed by ERGEG concern Third Party Access (TPA) to LNG facilities in accordance with Article 18 of the European Directive 2003/55/EC.¹ ERGEG seeks to design the GGPLNG to harmonize LNG operations to promote the internal gas market. Although the GGPLNG are intended to be non-binding, the intent is that the guidelines will form the basis of ERGEG's input on an amendment to the existing TPA regulations now set forth in Regulation 1775/2005 and its annexes.
3. Eurogas welcomes the attempt to define a general framework for regulated TPA to LNG facilities as more clarity in this area may facilitate efficient investment in LNG facilities where exemptions are not warranted.² However, Eurogas remains to be convinced that a high degree of harmonization of rTPA terms is possible, practical or necessary.
4. Sound regulatory practice should avoid onerous regulation where a light-handed approach can deliver policy objectives - regulation is not an end in itself. LNG development is robust and proceeding in the absence of the GGPLNG. Accordingly, the Guidelines and imminent LNG access regulations should not be too prescriptive but set general principles that do not disrupt the significant progress already being made by the LNG industry.
5. Moreover, new LNG developments are contributing to wholesale competition by encouraging entry of new gas suppliers. According to the Commission's recent Energy Sector Inquiry report, 64% of the new LNG capacity under construction will be controlled by new entrants and many of these entrants appear to be active in the downstream wholesale and retail markets.³ Based on its analysis of proposed terminals,

¹ Article 18 establishes the implementation of a regulated TPA (rTPA) system to LNG facilities based on published tariffs whereby at least the tariff methodologies are approved by the regulatory authority prior to their entry into force.

² Eurogas also notes that a well defined rTPA regime for LNG is a pre-requisite to satisfying the test for exemption set forth in Article 22(1)(b).

³ Energy Sector report at paragraph. 888, p. 269

the Commission concluded that there is a “trend of entry of new players and therefore towards a greater degree of market integration and competition for EU gas markets”⁴

6. The Commission’s Energy Sector Inquiry findings indicate that the most significant barriers to competition in the internal market for gas arise downstream of the LNG access points. These barriers may have an impact on the efficient development of LNG infrastructure and creation of an internal market that will allow re-gasified LNG to flow freely across borders. Accordingly, European policy makers and regulators should continue to build upon LNG success by resolving downstream issues that are critical to delivery of new LNG supply to the internal European market.
7. Eurogas also emphasizes that the LNG industry has certain attributes that must be considered when designing access terms (regulated terms or non-regulated terms). Specifically:
 - The global LNG industry has developed numerous operational, safety and commercial practices throughout the many years of operation and experience.
 - The industry is very competitive on a global basis and this robust competition continues to drive investment, innovation and technological advancement. Consequently, LNG suppliers will seek markets that offer the best prices, services and regulatory stability. Accordingly, competitive market conditions will drive development of effective terms of access to LNG facilities.⁵ Guidelines should build on this by incorporating best practice and the experience of existing market participants in a set of general principles.⁶
 - Investment in a regasification facility is a significant investment but is a relatively small component of the LNG value chain. Accordingly, LNG suppliers may hold regasification capacity as an option embedded within a larger portfolio and may find it profitable not deliver gas to such facility on a regular (i.e., base load) basis.
 - Regasification facilities are, nonetheless, significant investments that require long term capacity and supply commitments to support development.
 - An LNG facility must manage stock levels (including boil-off) carefully in order to manage the shipping schedule and the LNG supply portfolio. Consequently, there is not the same degree of flexibility in the LNG value chain as with an interconnected pipeline network with line pack and storage.

⁴ Id., at para. 889, p. 270

⁵ Eurogas members note that many markets, such as the USA, do not regulate LNG regasification facilities and that this is a factor that influences investment decisions.

⁶ Given the competitive environment, it is difficult to imagine how an LSO could be successful if it failed to “offer services that are compatible with the use of the interconnected gas transportation systems and facilitate access through cooperation with the Transmission System Operator (TSO)”. See Draft GGPLNG section 4.3.1(140(a)).

ERGEG GENERAL QUESTIONS

I. The GGPLNG aim is to boost effective, appropriately homogeneous and non-discriminatory, third party access to European LNG terminals without being detrimental to new investments. How could TPA/harmonisation and investment be conciliated?

II. The GGPLNG aims at facilitating harmonisation of services, procedures, conditions... in order to foster interoperability and facilitate access to regulated LNG facilities. To what extent is harmonisation of regulated access procedures convenient/possible? Which areas should be harmonised (i.e. transparency, network code procedures, balancing rules etc.)? Is the current degree of detail and prescriptiveness of the GGPLNG considered adequate? Is the need for common EU-wide requirements adequately balanced against the need for flexible rules?

8. Investment in regulated LNG regasification facilities can be promoted simply by establishing a stable regulatory environment that allows investors to earn a reasonable return on investment. Regasification facilities generally require long term ship or pay agreements to efficiently finance development of the asset. In addition, LNG suppliers and buyers require access to long term firm capacity to monetize large upstream investments. Therefore, LNG suppliers/buyers and LNG regasification developers enter into commercial arrangements that balance the relevant risks of investment. Establishing well defined rules of access and cost recovery *before commercial arrangements are made, not after*, will facilitate efficient investment.
9. It is important that these commercial arrangements are not frustrated or disrupted by well-intentioned rules designed to promote competition. For example, if access rules were designed to reserve capacity for "small shippers" or other new entrants, the cost of this capacity must not impose a penalty on the investors or primary users of the facility. Similarly, UIOLI and congestion management regulations should not negatively impact value, especially if they are imposed after investment has been made.
10. Given the significant differences between the regional European markets, it is very difficult to achieve a uniform level of harmonization among Europe's LNG market operators. Guidelines designed to harmonize general principles may lead to greater interoperability of the internal market whilst also respecting the different market circumstances and regulatory regimes of each Member State.
11. Some countries are heavily dependent on LNG for supply security while in others LNG is an opportunity to get new sources or to bridge temporary supply/demand gaps. Storage facilities always serve operational purposes but in some markets they are also used as strategic storage. Moreover, contractual provisions applicable to shippers regarding notifications, berthing requirements and unloading procedures have been designed for a specific terminal and may be difficult to replicate at another facility. Thus the Guidelines should focus on the general principles for regulated LNG facility access but be flexible enough to respect the various contractual arrangements in place and the unique circumstances of each Member State.
12. Harmonization, to the extent feasible, will continue to be driven by the competitiveness of the LNG supply industry. There is little practical value to imposing too prescriptive provisions since service design will be dictated by unique needs of the local market. For

example, shipping times to various European markets vary significantly and thus warrant a different set of timings for nomination and scheduling. Moreover, global competition and experience has already resulted in a degree of harmonization in LNG practices, including ship vetting procedures, scheduling, loading and loading practices, credit vetting, gas blending techniques and use of Delivery Ex-Ship (DES) sales transactions. New LNG technologies, such as on-ship vaporization, will continue to evolve and alter the way in which the LNG industry operates.

13. Regulators should be less ambitious with regard to LNG harmonization requirements and focus on only a few areas that can add value. The internal market for gas can be promoted by standardizing the process (including the timing and nature of notification) for allocating firm capacity in LNG facilities and establishing a standard process for the type of LNG flow and capacity data to be disclosed to the market. In addition, the Guidelines should require Member State NRAs to set forth the detailed terms of rTPA, including principles of best practice designed specifically for each Member State. Furthermore, Member States should establish rigorous and transparent procedures for Article 22 exemption processes and should be required to clearly articulate how other provisions of the Gas Directive will apply to exempt LNG facilities.
14. Accordingly, the best way to reconcile rTPA access provisions, harmonization and investment is to recognize that harmonization will evolve if guidelines reflect general principles that allow flexibility to adapt to Member State requirements and differences among the terminals.

III. Considering the voluntary character of the GGPLNG it would be interesting to know what transitional effects you think the GGPLNG implementation could cause, and what could the implementation cost be in your particular case. Are you going to get benefits (commercial, decrease of management cost etc.) with the GGPLNG application?

15. So long as it is clear the GGPLNG applies prospectively to regulated LNG regasification facilities, Members should not experience any detrimental impact resulting from voluntary application. So long as the GGPLNG is voluntary, narrowly focused and flexible the cost of implementation for existing and proposed facilities should be minor. If the GGPLNG is used to compel retrospective changes to existing arrangements, this must be recognized by the national regulator when approving amended terms and conditions and assessing revised costs within the tariff methodology process. In some instances, affected parties may need to be compensated for certain restructuring costs incurred as a result of the change. It must also be clear that LNG facilities that have already received Article 22 exemptions are not covered by the GGPLNG.
16. Improvements in the process for allocating capacity and the improvement of LNG transparency may add some value to the operation of the LNG market and the wholesale market downstream of LNG regasification terminals, but it would be difficult to plausibly quantify on such benefits. The GGPLNG may also be some benefit to the Article 22 process because it will allow parties to use one general standard of regulation to establish that "the investment would not take place unless an exemption was granted".
17. However, the presence of the GGPLNG and its subsequent status as a mandatory regulation could add increased administrative costs to project development and use, but this may lessen over time as all parties, including regulators, increase familiarity with

the GGPLNG. In addition, if unduly onerous provisions were adopted (e.g., restrictive UIOLI provisions) then the costs of having the GGPLNG could outweigh any benefit.

IV. The GGPLNG do not apply to terminals exempted under Article 22 of Directive 2003/55/EC. In your view, could there be any value for regulators to use some recommendations in the GGPLNG as an input when adopting individual exemption decisions (for example, as approval requirements when granting a conditional exemption). If yes, please explain why and with regard to which aspects of the GGPLNG (e.g., services definition, transparency obligations etc.)?

18. Regulators may find some value using the GGPLNG when considering exemption conditions. For example, sections 5.3 (Congestion Management) and 6 (Transparency) may be helpful so long as applicants specify, and regulators expressly authorize, the precise conditions that satisfy the GGPLNG. Other provisions may be less directly applicable, although elements are still useful and informative for exempt facilities. However, regulators need to be mindful that application of rTPA terms to facilities that promote competition (i.e., that meet the exemption tests under Article 22) may be redundant, counterproductive and unnecessary. It seems incongruous that regulators would apply rTPA provisions to a facility that is exempt from rTPA.

TARIFFS FOR ACCESS TO THE SYSTEM

V. The GGPLNG establish that tariff structure should be reviewed on a regular basis. Would the GGPLNG fix a minimum and/or maximum frequency for such a review? Which frequency(ies) should be the appropriate?

19. First, there appears to be no need for a separate mechanism for tariff setting principles applicable to LNG facilities. The general principles for tariff setting should apply equally to all regulated assets, such as storage, distribution and high pressure transmission. This section should reflect this by focusing on general principles.

20. Second, the frequency of review must reflect the unique circumstances of the relevant asset (including the financing arrangements) and regulatory framework of a Member State. For example, there may be a limited need to frequently review tariffs for an asset that has already been built and financed using long term debt as few cost variables would change over the life of the asset. We assume that LSOs will develop and finance an LNG facility on a stand alone basis using long term agreements to mitigate utilization risk of the facility and that this would be the case regardless of whether the facility is regulated or exempt. Under such circumstances, we see little need for a periodic review of tariffs and we would be concerned that such review could discourage investment.

21. However, we recognize that there are other ways to support capacity development, including the practice of requiring a percentage of a facility to be made available to third parties on a short, medium or long term basis. Such a practice may require a different approach to tariff setting and periodic reviews. Again, such issues can only be addressed by the individual Member States.

22. Regulatory stability is important for investors and system users. Member States should establish sound regulatory procedures in advance of tariff setting procedures. It is important that review processes are robust and transparent and that all interested

parties can participate in the procedure.⁷ Tariff reviews conducted in the absence of robust procedural protections for investors and system users, could add costs to development due to increased regulatory risk.

TPA SERVICES

VI. The GGPLNG assume that there may be benefits for the liquidity of the capacity market and for the system efficiency in offering not bundled and interruptible services in addition to bundled and firm services¹⁷. Do market players agree with this statement? What could be your interest in offering/contracting not bundled services and/or interruptible capacity? What type of services should be offered as no-bundled? What type of services should be offered as interruptible? Should the GGPLNG be more/less prescriptive on these issues?

23. The trade of unbundled components of the TPA services is limited by the fact that the components are inextricably linked. For example, the use of operational storage and send out is limited by the need to physically unload a subsequent cargo to replace stock levels. Accordingly, a party seeking to purchase only send out capacity will also need to compensate the primary capacity holder for replacing the gas in store with a new cargo and such compensation would include price risk and lost option value. Although this is possible, the example highlights the difficulty in selling parts of the bundled LNG regasification service as separate unbundled components.
24. The creation of such services would certainly not hinder global trade or OTC development of LNG capacity products but many Eurogas members doubt the level of interest of offering unbundled access/capacity services at LNG facilities and even the possibility of offering interruptible regasification capacity. Many Members believe it is impossible to offer services that can be interrupted by the primary firm users of the system. However, there is the possibility of offering additional services to the primary capacity holders on a reasonable endeavors basis (i.e., increased daily send-out). Such services need to be defined and made transparent to LNG system users.
25. The offer of unbundled and interruptible storage services may be envisaged when the storage capacity at the LNG facility exceeds the operational needs of the facility and can be used for strategic purposes.
26. Regasification/send out is closely linked to the shipping schedule and the need to manage stock levels and disruption will likely have a negative impact on the shipping and liquefaction arrangements of the primary user. Therefore, creating an interruptible service requires more thought on the practical limitations given the inextricable link between the various components of the LNG service.
27. If, however, the GGPLNG insists that an interruptible service be established, standard tariff design and cost allocation practice should be adopted for this service. The tariffs for firm and interruptible service must be cost reflective and without cross subsidization. Thus, a percentage of the fixed costs of the asset should be allocated to the interruptible service category (ensuring no cross subsidy with firm users) and the LSO should be placed at risk for under-recovery of these costs due to the lack of use of the interruptible service.

⁷ In this regard, Eurogas urges adoption of its proposed Guidelines on Good Regulatory Practice.

28. Experience thus far in the global LNG industry (including experience in Europe) indicates that secondary capacity trading and use of interruptible capacity has not yet emerged. The competitive global LNG supply industry is accustomed to using Delivery Ex-Ship transactions (“DES”) to access different markets as these mechanisms are well developed and easier to accomplish for a variety of reasons, including safety. Moreover, the market value of secondary capacity is reflected in the DES price struck by the relevant parties and will reflect the scarcity or abundance of LNG regasification capacity.

VII. The GGPLNG recommend that standard bundled services are defined after market consultation, especially concerning the flexibility included. In line with that, they emphasize the importance of taking into account the LNG facility’s technical constraints. Do you agree with this approach? Would a more prescriptive approach regarding the parameters for the definition of standard bundled services and their flexibility be feasible and/or more appropriate?

29. The recommended approach is practical and appropriate as each facility and the relevant circumstances applicable in a Member State will dictate the nature of services to be made available. Rigorous and transparent consultation procedures will facilitate efficient and flexible design. A more prescriptive approach will be costly and unproductive. NRAs should insure that the services are reasonable, non-discriminatory and transparent. However, NRAs should be careful not to over step their authority by mandating prescriptive commercial terms that are not compatible with LNG industry requirements.

VIII. According to the proposed GGPLNG, the LSO shall offer on the primary market long-term and short-term services at LNG facilities. Do you consider, from a TPA perspective, that any further guidance can/should be given with regard to a balance between long and short term services?

30. The GGPLNG is not sufficiently precise in its description of the nature or duration of short term services. Service design should be dictated by the requirements of the market and the impact on the efficient financing and development of LNG assets. If an LSO is required to offer capacity on a short term basis (e.g., 5 years) then the cost of this service, including the increased cost of capital associated with the increased risk of short term services, should be targeted to the users of the service and should not be subsidized by other long term users. As with tariff design for interruptible service, tariffs must be cost reflective and there should be no cross subsidies. Therefore, fixed costs should be allocated to the short term service and the LSO should be placed at risk for under-recovery for costs associated with short term services.

IX. Requests have been made during the July pre-consultation with stakeholders for specific standardised regasification contracts (e.g. front month contract) that aim to facilitate the trading of the regasified LNG on natural gas markets. What type of standardised services could be offered by the LSOs? To what extent would these services be compatible with technical constraints (e.g. available storage capacity), the efficient operation of each terminal and innovation in the offering of terminal services? How prescriptive should the GGPLNG be about standardised contracts?

31. It is not clear what is meant by a “front month contract”. Stakeholders may be referring to a service whereby a 30 day uniform send out profile is achieved (referred to as a “rate-able” send out) in situations where different LNG shippers are using the

facility by alternating cargo deliveries during the month. Unless different LNG shippers agree to share LNG stock in storage, an alternating delivery schedule will compel each shipper to send out gas over a short period (typically 7 days) in order to make room in the storage tanks for delivery of the subsequent cargo. It is difficult for the LSO itself to offer this service as an LSO is not responsible for delivering physical volumes of LNG to manage the stock necessary to provide a rate-able service. Also, such a service may require additional tank space which may be expensive and difficult to build.

32. Such a service is desirable, but is extremely difficult to establish as there are many complex factors to be considered, including credit issues among shippers using the facility and the calculation of damages for failure to deliver. Moreover, the ability to offer the service is dependent on the nature of the storage facilities, the liquidity and volatility in the downstream wholesale markets and the reliability of subsequent LNG cargo deliveries. NRAs should hesitate to compel LSOs or LNG shippers to offer the service as that would effectively mean that NRAs are dictating commercial terms.
33. So long as multiple system users are able to transfer title to LNG in storage, there are often ways for the LNG shippers to swap positions in order to achieve the desired send out profile. Furthermore, there may be other ways to address this situation. Onshore storage facilities may be able to design services to manage LNG profile issues, LNG sellers may be able to design profiles to suit different down stream buyers, and the traded wholesale market may offer financial products to facilitate the off take profile needs of the market. In any event, the service should be established on a case by case basis taking into consideration the relevant circumstances of the market.

X. Considering that harmonised network codes should take into account specificities of each terminal, which issues could be common and under which conditions?

34. There should be general principles on the process for allocating firm LNG capacity prior to the development of a new or expanded facility and for capacity that subsequently becomes available. Other than that, Eurogas members do not believe it is possible or desirable to strive for a high degree of harmonization of services among European LNG facilities.

XI. Electronic communication tools seem to be the most suitable means for the LSOs to exchange information with the terminal users. What type of platform could be needed? What services should be available on it (e.g. secondary market, nominations, etc.)? Should a simplified system based, for example, on fax transmission be envisaged in certain cases and, if so, when?

35. Electronic communication tools are surely the most efficient way for the LNG system users to exchange information with the LSO, in particular a web-based platform is the best way to nominate. But if a fax transmission accomplishes the task efficiently, Eurogas Members would have no objection.

XII. Even though several platforms already exist and software could be copied to a certain extent, the development of electronic communication tools represents a certain cost. Do you think the cost/benefit ratio would be acceptable?

36. The cost benefit of a software platform is a matter that is relevant to the tariff setting process. Decisions on any specific platform do not seem to be an appropriate subject for the GGPLNG to address.

XIII. The GGPLNG consider the cooperation between LSOs when putting in place compatible scheduling procedures in order to facilitate capacity trading and interoperability between European terminals. Do you think that such a harmonisation of scheduling procedures is desirable? Would it be necessary and proportionate to introduce some minimum harmonisation of these procedures within the GGPLNG to facilitate capacity trading and interoperability between European terminals? What requirements can be envisaged?

37. Regulated LSOs should strive to standardize scheduling procedures, including the establishment of a uniform start date for the prompt month as well as a uniform lead time for scheduling. Moreover, it would be helpful if the industry could utilize a standard unit of measure. These rules should be made transparent. However, NRAs need to recognize that the long experience in global LNG trade has already resulted in standardized scheduling procedures. Moreover, each market may require its own variation to accommodate unique circumstances.⁸ Furthermore, procedures in place for existing facilities may be difficult to change without causing disruption.
38. NRAs should examine the scheduling procedures of regulated LNG facilities to determine whether they are reasonable, non-discriminatory and fit for purpose. NRAs should also be mindful that the scheduling procedures should not restrict the use of the capacity by the primary firm shippers, including the flexibility embedded in the service.

CAPACITY ALLOCATION AND CONGESTION MANAGEMENT

XIV. The GGPLNG propose some concrete solutions in order to implement the very general principles laid down in Regulation 1775/2005 (Articles 5.3. and 5.4). Comments on these issues would be most welcome:

- Non discriminatory allocation rules for primary and secondary capacity are necessary to promote competition. The GGPLNG propose market-based solutions and other alternative mechanism as pro-rata or first-come-first-serve procedures. Should a reference to specific subscription procedures be included? Is there any other procedure that the GGPLNG should take into account?
- Regarding congestion management, is the development of a secondary capacity market sufficient to optimise the utilisation of the terminal capacity?; and
- Should the GGPLNG be more or less prescriptive regarding procedures to manage congestion in the terminals?

39. The allocation of primary capacity (both initial capacity and firm capacity that becomes permanently available) should be subject to more detailed procedural rules to ensure that the chosen allocation methodology and implementation of such methodology is non-discriminatory. Specifically with regard to auctions, the regulatory framework must clearly address situations where the auction results in an asset valuation that deviates from the underlying costs of the asset to be regulated.
40. In addition, the process needs to address models that require a certain percentage of firm primary capacity to be set aside for new entrants or short term services. Given the varied nature of individual Member States, the focus should be on development of

⁸ For example, the loading and shipping time from Algeria to parts of Spain is about 2 days, but is 3-4 days for the UK. In addition, gas quality and blending issues are different for each terminal and may require a different ship vetting and unloading procedure. Accordingly, scheduling processes must accommodate these differences.

standard and robust allocation procedures rather than the details of the methodology itself.

41. The presence of a secondary capacity trading mechanism should not cause any negative impact on utilization of LNG terminal capacity. Optimal utilization will continue to be driven by global price signals and the use of DES transactions to access different markets around the world. The presence of prescriptive secondary capacity mechanisms designed by ERGEG will not change the incentives to flow cargoes to higher priced markets in other parts of the world and primary users should not be penalized for reacting to these market signals. Moreover, given the robust competitive global LNG market, DES transactions are market based, transparent and non-discriminatory and thus satisfy the requirement for allocating secondary capacity set forth in proposed section 31.
42. Accordingly, the GGPLNG must recognize the role that global prices have on LNG market flows when designing primary and secondary capacity allocation mechanisms. It should allow Member States and LNG suppliers to develop mechanisms appropriate for the circumstances present in its market.

XV. Reference is made to capacity that the holder is no longer able to use. An obvious example is the case of (unbundled) regasification capacity owned by a shipper who has no more gas in storage. What are the other cases where capacity could be categorised as no longer usable? Who must decide when a capacity holder is considered as no longer able to use the capacity?

43. The fact that a user has no more gas in storage (with the exception of minimum stock levels) does not necessarily indicate that the facility is unused as the shipper may be in the process of delivering a cargo to meet minimum stock levels. Generally, a facility is not being used if LNG is not being delivered to a facility when global market conditions suggest that LNG should be. However, circumstances are unique and should only be scrutinized by an NRA after the event, subject to placing the burden of proof upon the NRA that a facility was not being "used". There is a risk of creating presumptions of when a facility is "not being used" as such presumptions may impair the commercial arrangements made by primary capacity holders. National regulatory authorities should define "capacity hoarding" and clearly articulate the circumstances that will give rise to an investigation of such an offense. However, NRAs must recognize that capacity may go "unused" due to global price signals and other legitimate reasons and that these price signals may not be readily transparent.

XVI. Regarding the allocation of capacity, the GGPLNG stipulate that the LSO might allocate the standard bundled LNG services with a priority upon not bundled services in order to maximise the use of the LNG facility. In your view, under what circumstances would it be appropriate to give such a priority to bundled services?

44. Because it is extremely difficult to use separate components of the LNG service, it is difficult to imagine circumstances where allocation of unbundled services would be given a priority over a bundled service. The trade of unbundled components of the TPA services is limited by the fact that the components are inextricably linked. For example, the use of operational storage and send out is limited by the need to physically unload a subsequent cargo to replace stock levels. Accordingly, a party seeking to purchase only

send out capacity will also need to compensate the primary capacity holder for replacing the gas in store with a new cargo and such compensation would include price risk and lost option value. Although this is possible, the example highlights the difficulty in selling parts of the bundled LNG regasification service as separate unbundled components.

XVII. The GGPLNG tries to assure the optimum utilisation of the terminal and to avoid capacity hoarding by promoting capacity reallocations when appropriate. How can the balance be struck between the promotion of the secondary market of capacity and the protection of primary capacity holder's interests?

45. In order to address this question fully, the definition of "capacity hoarding" must be provided.
46. It is difficult to strike a balance between the interests of primary capacity holders and promotion of secondary capacity trading if the two categories are given equal priority. NRAs must recognize that primary capacity holders have made financial commitments that have allowed the facilities to be built in the first instance. Accordingly, the interests of primary capacity holders can be protected if 1) they are fairly compensated for the market value of the surrendered capacity as well as any other reasonable costs and risks incurred (e.g., liability associated with the negligent use of the facility by a secondary shipper), 2) the details of the capacity hoarding mechanism are agreed by all parties, including the NRA, prior to finalization of the relevant commercial arrangements and 3) primary capacity holders are fully compensated for changes to the agreed mechanism imposed by NRAs after commercial agreements have been completed. Again, there is a danger that regulators supplant its interpretation of what constitutes "optimal" utilization as this may be inconsistent with the commercial realities of the global gas market.

XVIII. The GGPLNG distinguish between punctually unused capacity and systematically underutilised capacity:

- The definition of unused capacity refers to a deadline by which the capacity holder must nominate its use. This concept is defined in Regulation 1775/2005, art. 2.4. Do market players agree with the definition of unused capacity? Is a more or less detailed definition needed? What conditions/circumstances should be taken into account when assessing whether capacity is effectively used or not?

47. The definition of "unused capacity" and "capacity" set forth in Regulation 1775/2005 are not sufficiently precise to reflect the operation of LNG facilities as the definitions have been designed for pipeline systems that use day ahead (and shorter) timeframes for nominations and re-nominations. LNG nomination procedures typically do not require that tank storage capacity be nominated separately because use of the storage component is embedded, and thus implicit, in the service. In other words, a reduction of send out implies that the storage component will be used. Accordingly, the current Regulation implies that failure to nominate a berthing slot means that the facility is not being "used" when, in fact, other components of the LNG service are being used. Accordingly, the definition of "capacity" and "unused capacity" need to be made more precise to accommodate the unique circumstances of LNG facilities.

- Is there a need to distinguish between punctually unused capacity and systematically underutilised capacity as states the current draft of the GGPLNG? Is the proposed split between reallocation of unused capacity and release of underutilised capacity a good approach?
- Is it satisfactory to empower the NRA to evaluate if there has been systematic underutilisation of capacity or should the concept of 'systematic underutilisation' be described more accurately in the GGPLNG, by specifying the criteria to be used?

48. The prospect of stripping the primary capacity holder of its capacity rights on a permanent basis causes great concern among Eurogas members. Any procedure designed to remove property rights must be based on established and robust criteria and must carefully consider the consequences on all participants, including investors. First, the Regulations and NRAs must provide a definition of "capacity hoarding" and "systematic under utilization". Second, the rules must be clear that the relevant NRA has the burden of proof to establish that systematic under utilization has occurred. Finally, the primary capacity holder must be compensated for all losses associated with the taking of its property right – not just relief from paying future capacity charges.

XIX. Is it necessary to impose detailed congestion management mechanisms as proposed in these GGPLNG, or should the GGPLNG content themselves a set of general principles? Are the solutions proposed in the GGPLNG adaptable to the varying, present and future, situations?

49. Given the difficulty of addressing the unique circumstances present in various European markets, the GGPLNG should set general principles for LNG congestion management.

XX. Setting the right deadline or notice period is considered as a key factor for the congestion management procedures. Comments on this issue would be welcome.

- Should the GGPLNG include more or less detailed/prescriptive provisions on deadline/notice periods regarding unused capacity?
- What circumstances should be taken into account by the LSO/NRA when determining/approving notice periods. Is there a single specific deadline/notice period appropriate for all solutions? If so, what could it be?
- Is the NRA the most appropriate party to define the deadline or notice period? Otherwise, who should be responsible for setting the deadline/notice periods?

50. Proposed section 38 (a) attempts to strike a reasonable balance between the right of a primary shipper to retain flexibility and value in the capacity paid for and the interests of a potential secondary shipper. Specifically, the notice period "must be long enough to allow for another shipper to organize a shipment and short enough to allow capacity holder to determine which capacity it is not using". However, the flaw with this approach is that it deprives the primary shipper of its contractual rights to use capacity and grants that right to a secondary shipper. Specifically, at a specific point in time, the primary capacity holder is no longer entitled to "organize a shipment" but a secondary shipper is so entitled. Given that the primary capacity holder has financially backed the development of the asset in the first instance, it seems that the proposed mechanism results in unequal treatment. If NRAs are insistent that secondary shippers be given such preferential rights, then primary shippers must be compensated accordingly.

51. Given the different market circumstances, including shipping times and the presence of a traded wholesale market, individual Member State NRAs must establish the appropriate balance. In addition, the individual NRAs can consider the impact of the deadline (and corresponding reduction in flexibility) on the value of the commercial service and the impact on supply security. The choice of the appropriate deadline must be justified and take into consideration local circumstances.

XXI. The GGPLNG establish the principles to release underutilised capacity, setting some detailed circumstances where this may happen and assigning responsibilities to NRAs. Should the GGPLNG be more or less prescriptive on this issue? Do the circumstances set out in the GGPLNG cover all present and future circumstances where underutilized capacity should be released? Would a less constraint mechanism be preferable?

52. The congestion management principles contained in the proposed regulations must recognize the unique aspects of the LNG industry and the difficulty in applying congestion management mechanism designed for storage and pipelines to the global LNG industry. Congestion management principles work very well for a highly interconnected gas network with multiple shippers holding title to gas in a commingled stream. The LNG industry, although globally interconnected, is much different in that the time frame needed to manage cargo delivery is much longer than that needed by an interconnected pipeline network. Nonetheless, global LNG suppliers retain a degree of flexibility and optionality in their portfolios which is growing. Furthermore, as the industry develops, the ability to adjust deliveries on shorter notice to take advantage of price volatility and arbitrage will expand. Accordingly, when dictating the congestion management obligations applicable to an LNG facility, NRAs must act cautiously so as not to eliminate or reduce commercial value.
53. A primary capacity holder retains a high degree of flexibility in the use of its capacity in order to optimize the commercial position in its global portfolio (or the global portfolio of its LNG supplier). To optimize a global portfolio, an LNG supplier may need to adjust the various components of the regasification service. For example, the primary capacity holder may be using the storage component to manage the timing of a shipping schedule.⁹ Accordingly, failure to nominate a berthing slot or send out does not mean that other components of the bundled service are not being used. However, since no one would use a berthing slot if it did not come with other components of the service, it does not seem efficient to develop a mechanism to sell berthing slots in the secondary market. It would also be inefficient to design a service to compel the secondary sale of a bundled service if at least one of the components is being used by the primary shipper.
54. Accordingly, failure to nominate a berthing slot should not be deemed as unused capacity if this means that the user / holder of the capacity must surrender its commercial interest by forfeiting its right to use all the service components. If Member State regulators believe it is necessary to compel forfeiture of flexibility in order to satisfy the UIOLI principle, then primary users must be compensated fully for the quantifiable loss of flexibility and other reasonable cost exposure. Accordingly, proposed GGPLNG section 36 must be clarified to insure that the "reasonable price" of capacity offered on the secondary market includes compensation for lost market value associated with surrendering rights to flexibility and other reasonable cost exposure.

⁹ An LNG supplier may reduce send out in order accommodate a delay in subsequent ship arrival as this is necessary to maintain minimum stock levels. In addition, a supplier may be serving seasonal load and will hold gas in stock for months. Thus the facility is being "used".

55. It is difficult to determine when capacity is not being used and “hoarded” and the consequences of taking capacity rights away from the property owner are significant. Accordingly, the burden of proof should be placed directly on the Member State regulator and complaining parties to demonstrate that capacity is not being used and would have been used had the primary shipper relinquished capacity in the secondary market.¹⁰
56. The complexity of this issue is addressed by proposed section 38 (a), which attempts to strike a reasonable balance between the interests of primary capacity holders who support investment in LNG facilities and a class of secondary shippers who do not yet exist. Moreover, proposed section 38 (a) should require the NRA to make a definitive determination prior to investment so that interested parties can calculate any loss of value associated with restrictions on flexibility such that the value can be considered as part of the total value of the LNG investment. Specifically, the notice period “must be long enough to allow for another shipper to organize a shipment and short enough to allow capacity holder to determine which capacity it is not using. Together with the scheduling procedures, it must be submitted to consultation according to § 10a herein. The notice period shall be defined by the NRA based on the opinion of existing capacity holders and other market participants in the public consultation.”
57. Given the complexity of the Congestion Management issues, the GGPLNG should adopt the following general principles for Member State NRAs to consider when satisfying this requirement:
- a) The GGPLNG should define “capacity hoarding” so that it can be applied across all Member States and be used for all gas assets.
 - b) The GGPLNG should require all Member States to establish a congestion management mechanism after a transparent and public consultation. The Congestion Management mechanism must be expressly approved by the relevant NRA *prior to* finalization of the commercial arrangements applicable to the LNG facility.
 - c) The Congestion Management mechanism must reflect the unique circumstances of the relevant market, including the applicable regulatory framework for recovery of asset investment. The mechanism should also reflect how utilization risk of the investment is managed, by whom (e.g., the primary shipper, the LSO or other network users), and specify how the congestion management mechanism will impact allocation of utilization risk.
 - d) The mechanism should not be unduly prescriptive by requiring an auction for allocation of secondary capacity if it is clear that OTC markets (including the market for DES transactions) are sufficiently robust to achieve efficient use of capacity.
 - e) The mechanism must address credit and liability issues associated with use by the secondary shipper, including the cost to the primary shipper of failing to deliver a cargo.
 - f) The tariff charged to the primary capacity holder must reflect the diminution of flexibility caused by adoption of a secondary capacity mechanism. In addition, the GGPLNG should require that all secondary capacity and UIOLI mechanisms compensate the primary shipper for the

¹⁰ This may require proof that global LNG prices would have resulted in gas being delivered to the LNG terminal in question.

market value of the capacity surrendered and other reasonable costs associated with the use of the capacity by a secondary shipper. These costs would include reimbursement for the secondary shipper's failure to evacuate space in the storage tanks in a timely fashion.

- g) Secondary shippers must be bound by the same rules designed to prevent capacity hoarding. In other words, secondary shippers must release capacity not "used".
- h) The GGPLNG should require that the relevant NRA has the burden of proof to establish that the facility is not being used and should have been used by the primary shipper in the relevant time frame and such burden can only be met by substantial evidence.

TRANSPARENCY REQUIREMENTS

XXII. The GGPLNG try to summarise the most important operational and commercial information to be published by the LSOs. What other types of information should the LSOs provide to the market to improve the transparency and the efficiency of the market?

XXIII. In your view, are there other points regarding transparency that should be addressed in the GGPLNG?

- 58. Generally, the proposed transparency provisions seem thorough and robust. However, the proposed rules state that LSOs "shall make public the amount of gas in storage, inflows and outflows . . . [and] [t]he information shall be updated at least every day."
- 59. Eurogas does not object to disclosure of this information in a manner that is consistent with treatment of similarly situated facilities. However, some LNG facilities may have only one or two shippers and thus disclosure may impair commercial activity. Accordingly, NRAs must examine disclosure requirements on a case by case basis, consistent with the procedural protections provided by the current "3 –shipper rule".
- 60. Eurogas is not essentially opposed to removing the 3-minus rule from the Gas Regulation as long as the level-playing field is maintained in all markets and there is balance between the benefit of its removal and appropriate protection of commercial interest of individual market players.

TRADING OF CAPACITY RIGHTS

XXIV. Opinions have been expressed that in some markets, organised trading of capacity rights might not be necessary, or that the benefits this trading provide to LNG terminal users could be reached by other means. Is an organised secondary capacity market in the terminal useless, useful or necessary? Should the GGPLNG recommend the creation of a secondary market for capacity or should this be left to each LSO or NRA's appraisal?

- 61. The competitive global LNG industry is accustomed to using DES transactions as the means to access secondary capacity. In addition, the excessive cost and complexity of establishing an explicit secondary capacity market could outweigh any benefits. Moreover, there is a significant risk that the zeal to create secondary markets will impair

the efficient use of capacity by primary users. Accordingly, an organized secondary capacity market for LNG is of little use.

XXV. Considering a need for a secondary capacity market in the terminal, what features would be needed for an efficient functioning of this market? Comments on this issue would be welcome, i.e.:

- How crucial is contracts' standardisation for the development of secondary market?

62. Standardization of the secondary market has already taken place in the global LNG industry and will continue to evolve, driven by competition. LSOs should not hinder development of secondary capacity trading and could facilitate such trading by cooperating with ship vetting and gas quality assurance. However, secondary use of capacity requires the cooperation of the primary shipper due to its need to manage stock and the shipping schedule. So long as the primary shipper is fairly compensated for market value and other risk, then secondary capacity trading will emerge and supplement use of DES transactions.

- Should contracted capacity that has not been nominated be offered on the secondary market by the LSO if the capacity owner does not do it?;

63. Giving the LSO responsibility for marketing secondary capacity is difficult because they are not as well placed to market the capacity as the primary capacity holder, thus increasing the risk of underutilization. In addition, unless the LSO is compensated for its efforts, they lack incentive to market the secondary capacity, especially if a ship or pay agreement has covered all fixed costs and the LSO's return on investment. Furthermore, if the primary shipper is required to surrender unused capacity to the LSO for subsequent marketing, the primary shipper should be relieved of any obligation to pay for such capacity; regardless of whether it is subsequently sold. We note that the Belgian LSO has the ability to market unused capacity. To our knowledge, it has never done so successfully.

- What is your interest in the offer/demand of not bundled capacities on the secondary market (e.g., berthing capacity, storage capacity etc.)? Have you encountered obstacles regarding this that would justify developing more specific rules about the trading of not bundled LNG services in the GGPLNG?

64. The trade of unbundled components of the TPA services is limited by the fact that the components are inextricably linked. For example, the use of operational storage and send out is limited by the need to physically unload a subsequent cargo to replace stock levels. Accordingly, a party seeking to purchase only send out capacity will also need to compensate the primary capacity holder for replacing the gas in store with a new cargo and such compensation would include price risk and lost option value. Although this is possible, the example highlights the difficulty in selling parts of the bundled LNG regasification service as separate unbundled components.

65. The creation of such services would certainly not hinder global trade or OTC development of LNG capacity products but many Eurogas members doubt the level of interest of offering unbundled access/capacity services at LNG facilities and even the possibility of offering interruptible regasification capacity.

66. The offer of unbundled and interruptible storage services could only be envisaged when the storage capacity at the LNG facility exceeds the operational needs of the facility and can be used for strategic purposes.
67. Eurogas believes the competitive LNG market has been innovating successfully and the OTC market will continue to evolve to accommodate the needs of LNG suppliers and gas buyers.