

**EFET¹ views on the EC draft LNG policy paper
presented at the 15th Regulatory Gas Forum Madrid,
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Summary of key points

- *The development of LNG trading and arrangements for access to LNG terminals must be non-discriminatory and facilitate participation of all willing parties whether large or small, active players or new entrants.*
- *Diversity and choice in bundled and unbundled LNG terminal capacity products should be encouraged*
- *There is potential for new LNG trading products and some degree of contract harmonisation at LNG terminals, but an overly prescriptive approach could frustrate innovation*
- *Rights purchased under a contract for LNG terminal capacity should be assignable and free to sell on to third parties*
- *Improved transparency should provide a stimulus for increased trading, and further discussion with the terminal operators is recommended.*
- *The notification period for making available unused terminal slots is a key factor but anti-hoarding measures should be recognised as just an extreme 'backstop'. The priority issue should be to ensure that there are effective arrangements for trade in secondary capacity.*

Introduction

EFET welcomes the opportunity to comment on the draft paper presented by the European Commission at the 15th Madrid Forum. In our response to the consultation on the Guidelines of Good Practice on Third Party Access for LNG System operators (GGPLNG) from January 2008 (available at <http://www.efet.org/default.asp?Menu=283>), we had already formulated our views on harmonisation of trading arrangements at terminals, provision of bundled and unbundled services, tariffs, capacity allocation and congestion management procedures. In this note, we outline some further views on the LNG market in response to the European Commission's analysis.

¹ Established in 1999, the European Federation of Energy Traders (EFET) is an industry association representing over 90 trading companies operating in some 25 countries. The EFET mission involves improving conditions for energy trading in Europe and fostering the development of an open, liquid and transparent European wholesale energy market. More information about EFET views and activities is available on www.efet.org

LNG supply market

The EC's paper mentions that regasification, liquefaction and shipping capacities are at present out of balance, with a shortage of liquefaction and an apparent overcapacity in regasification. Our view is that this is not a cause for concern. A surplus of regasification capacity is needed in order to profit from price differences between the European, North American and Asian markets. The costs of regasification capacity are much less than liquefaction costs and do not significantly increase the costs for end-customers, as these costs only represent around 2% of the final gas price.²

It is important to keep this in mind when it comes to design a robust regulatory framework. We would caution against regulating particular parts of this supply chain based on perceived imbalances between supply and demand – there is a need to allow the market to react to any perceived imbalances. Additionally as the gas and LNG business is highly capital intensive and long term, we would caution against taking too short a term perspective when designing any new regulation.

In our view the market is more dynamic than described in the paper. Most cargoes can potentially be purchased either with a delivery ex-ship (where the destination is fixed) or free-on-board, which allows for the diversion of the cargo to high-price areas for those shippers willing to pay the premium for this flexibility. When considering the development of new and innovative arrangements that will increase the opportunities for all participants (whether they be new entrants, smaller participants or large established participants), it is important to take into account that single LNG cargoes can have values of the magnitude of \$20-\$30 million i.e. whilst trading involves whole cargoes the lot size and value will remain fundamentally different to that for gas traded at downstream hubs.

The LNG market in the EU (and indeed globally) is still evolving. Additional terminals are coming on-stream in Europe, and increased secondary capacity access should help to increase liquidity in the LNG market. We believe that the focus should be on further enhancing the liquidity of this evolving market by considering the potential for innovative new LNG trading products and facilitating the availability of secondary capacity.

In our view the force of self-regulating economics in the LNG market is greater than the assumed in the EC's paper, perhaps as a result of drawing from the pipeline concept ('firm between entry and exit'). Market participants throughout the LNG chain are, we believe, keen to use LNG as a way to monetise the price differentials between regions. This is evidenced during the last two years by flows of LNG towards Asian markets but as well by the recent increase in deliveries to European markets as netbacks of sales to European markets became more attractive (relatively). Internationally, LNG is, more flexible in flow patterns than uni-directional pipeline gas. This

² See p. 13, Summary report by the Working Group on the Regulation of LNG Terminals in France, April 2008.

responsiveness to price signals ensures that there is some natural pressure for “self regulating”.

The draft EC paper states in section 1.3.2 that access to short term LNG regasification terminal capacity is (an often imperfect) substitute for scarce Long Term capacity contracts. EFET disagrees with this notation and considers that the role, influence and impact of short term trading (of LNG) should be more recognised, and also that there should be some mention of secondary capacity markets. EFET believes strongly that both short-term LNG trading and secondary capacity markets should be encouraged and be seen as complementary to long-term contractual arrangements.

Regasification terminals

The EC’s paper makes some specific suggestions on access to the regasification terminals in Europe and defines action points for further analysis. We appreciate that the EC paper is in draft form and assume that in undertaking the actions planned, that clarification will be developed on the points raised within the EC’s draft, - for example the term ‘nominations’ mentioned with reference to transparency could be interpreted in a number of ways.

EFET comments as follows on the detailed areas of the EC’:

Commercial and technical rules

EFET agrees that technical access rules should not be part of a regulation. As stated in the paper, the right commercial incentives will ensure that appropriate technical rules are applied which do not restrict competition. An overly prescriptive approach could block innovation in a relatively young industry.

It is difficult to draw meaningful conclusions from comparing capacity tariffs at different terminals because they do not have the same construction and operating costs and are therefore not directly comparable. EFET does however believe that there may still be some useful learnings that might be gained by further comparison over time as the market develops.

TPA Services

Further clarification would be helpful about the statement in the paper regarding ‘optimising’ the value of terminal capacity for the EU. If this reference to ‘optimising’ is to actual value of capacity then this is a matter for capacity holders. If however the reference is to the benefits that capacity brings to the EU in terms of enhanced supply diversity and security of supply then it is important that the EC recognises fully the inter-linkage between primary and secondary capacity. That means: When creating incentives to stimulate secondary capacity, it is crucial not to disregard incentives for investment in primary capacity. Stimulating continuous delivery of additional

primary capacity will be the most effective way to create associated secondary capacity trading opportunities.

Standardisation of contracts

Whatever rights are purchased under a contract for LNG terminal capacity, they should be assignable and free to sell on to third parties (not just back to the terminal operator), subject of course to reasonable requirements of the terminal operator to safeguard their interests. Such freedom would help to stimulate secondary trading.

Within a terminal, product offerings to different potential capacity purchasers should be non-discriminatory. This is not to say there must be only a standard contract as some capacity purchasers may require different combinations of the products / services offered by an LSO. A standard contract might inhibit products offering flexibility and unnecessary limit commercial activity and the full exploration of the possibilities at a terminal.

Where practical, standardisation of contracts for LNG terminal capacity would offer significant benefits. It is however important to recognise that currently the trading of LNG regasification capacity will in general need to be more bespoke in nature than trading contracts on a gas hub, or even for pipeline capacity. The unit quantities and values are significantly larger for LNG than, for example, traded in downstream gas and there are relatively fewer trades taking place. That said, regulations should stimulate as much standardisation as practicable.

Provision of bundled and unbundled services

EFET encourages diversity and choice in products. It should be recognised that it is not only the technical possibility that is relevant but also the commercial and practical considerations. A particular product might be technically possible, but commercially extremely costly, and therefore the demand for such a product would likely not exist. The LSO is responsible for terminal offerings and potential capacity purchasers will doubtless seek to avoid unnecessary theoretical considerations. What is needed is a balanced assessment. LSOs should be encouraged to consult with shippers about possible new services which could be of interest e.g. the re-loading of cargos at a terminal or separate trading of regasification terminal berthing storage and send-out capacity.

Gas quality

EFET does not see the immediate need to establish a minimum gas quality requirement at the entry to LNG terminal. In theory one would argue that any cargo should be able to deliver into any terminal to stimulate trading to the greatest degree. However if this were to be facilitated, it would raise the question 'if treatment pre-terminal entry was required who pays the bill for quality treatments?'

In addition perhaps the biggest question is the likely impact on the attractiveness of the EC as a market for LNG if minimum gas quality requirements were imposed at LNG terminal entry in the EC but not elsewhere in the world LNG market. At a time when the EC is considering security of supply issues, supply diversity, and ways of attracting supplies including LNG, it could be argued that the imposition of a minimum gas quality could be detrimental to security of supply.

It is a separate question as to what extent - if any - gas quality requirements could be standardised at LNG regasification terminal exit into TSO networks. This is of course hugely influenced by prevailing quality requirements of the different networks into which the LNG terminals flow gas. The five-year project currently being undertaken by CEN is considering such issues. We note that, in the meantime, EASEE-gas has a voluntary Common Business Practice quality specification that could be applied at the exit of LNG terminals.

Harmonisation with downstream transmission system

The prevailing entry capacity regime is a key issue for each relevant market. For example in France capacity is automatically matched to terminal capacity, but this however is not the case in all markets e.g. in the UK a complex entry capacity regime makes purchasing decisions challenging. Therefore one needs to be specific when considering the implications of issues related to flowing gas in different TSO regimes, a question to which EFET refers to in its Capacity paper (*The allocation of Primary Gas Capacity*, <http://www.efet.org/default.asp?Menu=283>) which provides further comment.

Anti-hoarding measures

We consider that the notification period for making available unused terminal slots is a key factor in ensuring anti-hoarding measures to be effective. This should be considered on a case-by-case basis, and the determination of appropriate measures driven by the objective of preventing hoarding.

It is important to maintain the clear distinction between anti-hoarding measures and secondary capacity arrangements. Anti-hoarding is in effect a backstop measure, which needs to accommodate specific circumstances at each terminal. Separate from the anti-hoarding measures, the much more useful focus should be on stimulating secondary trading to provide access to unused capacity in a way that is acceptable to both primary and secondary users, designed by taking into account their views.

Transparency

EFET is supportive of appropriate transparency, which will provide a stimulus for increased trading. We recognise the benefit of having information on services, use and available capacity (for both regulated and exempted LNG plants when they offer unused slots). Such information could be classed as “prospective” and is key for secondary trading to be effective. The market needs timely information to be able to react. EFET also supports transparency

about access terms and conditions as well as tariffs charged when services are offered to third parties.

In the paper the EC raises specifically '*the usefulness of "prospective" transparency in which information on planned use of terminal capacity, in the form of nominations would be made available to market participants*'. It would be useful to clarify which particular 'nominations' the EC has in mind. For example the reference could be to berthing slot nominations, regasification nominations or TSO network entry capacity nominations. EFET would then welcome debate about the benefits of improved transparency on 'prospective nominations' would bring. This debate would be of greatest value if terminal operators were able to contribute views as to the type of information that might be made available. In general EFET favours full disclosure by infrastructure operators of all information in aggregate on the expected availability of capacity that could have any significant impact on the market. The debate will of course need to recognise concerns about confidentiality, commercial sensitivity and liability, and bear in mind the need to ensure that Europe is enhanced as an attractive destination for LNG.

EFET supports the undertaking of an analysis of the need for detailed rules on transparency with regards to services offered proposed in the draft paper.

**EFET Gas Committee & LNG Group
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