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Dear Mrs Geitona

National Grid Response to ERGEG Consultation on Article 22 Guidelines

National Grid welcomes the opportunity to respond to ERGEG's consultation on draft guidelines on Article 22 ("the Consultation"). Whilst the ERGEG paper relates to the Gas Directive, we also note the recent EC Working Paper on this topic prepared for the Madrid Forum which covers both gas and electricity exemption regimes (the latter being Article 7 of Electricity Regulation 1228). Our response is split into two parts, firstly some general comments regarding the draft guidelines and the exemption regime, and secondly comments on the specific questions raised in the Consultation

National Grid has also contributed to the GTE and GLE responses to this consultation, and fully supports their work on this important subject. This paper is therefore designed to complement these responses, by providing specific, supplementary comments with reference to the circumstances within the UK

National Grid has a number of gas infrastructure interests within the UK. We own and operate the National Transmission System (NTS) throughout Great Britain and own and operate a significant Gas Distribution network throughout the heart of England (both of these activities are regulated). The NTS is interconnected to continental Europe via two independent gas interconnectors - I(UK) and BBL. The NTS is also interconnected to Northern Ireland and the Republic of Ireland. A number of new independent gas infrastructure projects are currently underway including the new Dragon and South Hook LNG importation terminals (both subject to Article 22 Exemption requests).

In addition National Grid Grain LNG Limited, a wholly owned subsidiary of National Grid, has constructed an LNG importation and re-gasification terminal at the Isle of Grain in the south east of England. National Grid Grain LNG owns and operates this facility.

Given our reference to the EC Working Paper in paragraph 1 above, National Grid also operates the electricity transmission network in Great Britain and also owns the England and Wales part of this network. Again this is a regulated activity.

General Comments

1) By way of general introduction we believe the interpretation of the Article 22 (and Article 7) process is often confused in relation to the nature of the investment being considered. Major investments tend to fall into four categories: LNG Terminals, Gas Storage Projects, Transmission Projects and Interconnector Projects. The fact that in many parts of Europe the last two of these are often viewed as one and the same, leads to further confusion in interpreting Article 22. Within Member States transmission is regarded as a regulated monopoly activity generally with an accompanying regulatory regime which should encourage investment and hence avoid the need

for a regime like Article 22. In many Member States many people feel interconnector projects should also be subject to monopoly regulation by NRAs. However, as the EC's 3rd Package recognises, a mature regulatory regime within each Member State which encourages investment does not always exist yet, and in particular there is no EU or Regional regime which encourages or facilitates investment in inter-Member State infrastructure such as interconnectors.

2) We have therefore written this response with these different investment categories in mind. Whilst it might be broadly concluded that intra-Member State transmission projects should fall outside the Article 22 process, this can only be guaranteed if a robust investment climate is ensured by the regulatory regimes within each Member State. We look forward to the 3rd package ensuring such investment climates through development of NRAs responsibilities and the introduction of ACER. However, at present until pan EU or regional regulatory regimes are developed to cover interconnector projects between Member States, interconnectors must continue to be viewed as relevant in the Article 22 debate: otherwise we take the risk that such projects will not be developed.

3) Given the above, this response is written for the perspective of the UK regulatory environment which is significantly different to many other European regimes in that infrastructure such as gas interconnectors, LNG importation and storage facilities are developed in an open competitive market with investors bearing the associated risks rather than them being imposed on consumers via regulated tariffs. National Grid considers that where new infrastructure is developed on a merchant basis in a competitive environment where other parties could develop competing infrastructure that provide alternative means for importing gas into the UK then exemption from Article 22 should be seen as the default position and regulation should be light touch.

4) National Grid supports in principal the development of mechanisms that will ensure that decision making by regulators is undertaken on a consistent, timely and predictable basis. This will reduce risks and increase predictability for developers thereby encouraging new infrastructure projects and this (subject to competitive downstream markets) will increase competition and security of supply.

5) The regulation of merchant infrastructure within a competitive environment should be "light touch". The guidelines and Article 22 of the Directive as they stand assume a particular view of the world (rTPA to infrastructure such as LNG and the presence of incumbents with a dominant market position and limited competition in the downstream markets). The Guidelines therefore could impose significant and unnecessary levels of bureaucracy and delay on projects operating in a more open competitive environment. In general we do not consider that the guidelines give adequate weight to considering the impact of competition in the relevant markets (both in infrastructure and downstream). As noted above, we consider that where there is effective competition in provision of infrastructure and in the downstream markets then exemption from Article 22 should be the default position.

6) While the use of guidelines may bring consistency (if it is possible to apply them universally in a consistent manner) there is equally a risk that the additional complexity that they and Article 22 itself bring in terms of:

   a) the data that must be gathered,
   b) the various tests that need to be met, and
   c) the timescale and resources involved,

   will make Europe as a whole a less attractive location for infrastructure developers that have the option of developing projects in less heavily regulated markets such as the US, Asia, China etc. This could adversely impact on the development of such projects in Europe and therefore development of the internal market and security of supply within Europe. It is essential therefore that in a competitive environment regulation is appropriately "light touch".

7) It is important that guidelines should not increase or extend the powers of regulatory authorities beyond the limits in the Directive or other relevant legislation. If changes to the Directive are considered desirable then they should be introduced through the formal legislative process where proper analysis of the changes can be evaluated.

8) Finally, it is essential that developers of new infrastructure can see a stable regulatory regime if they are to be confident regarding the high levels of investment that will be needed to assist the development of the internal market and to secure Europe's energy supplies into the future. An essential feature of any regime therefore is that it does not allow the reopening of historic decisions except under the most exceptional of circumstances.

Questions for stakeholders

1 Do you consider the described general principles and guidelines appropriate to achieve a consistent and transparent framework for competent authorities when deciding on exemption procedures?

Guidelines will only be advantageous if they are adopted consistently by the appropriate regulatory authorities. There is little value to drafting such guidelines unless all authorities can and will use them consistently and this may be complex given the different nature of regimes in the EU.

Generally speaking we consider that the guidelines do not adequately address the need to consider the market conditions in terms of:

- competition between different gas delivery infrastructure projects
- competition downstream and
- market share / dominance of the various market participants

2 Do you consider the present scope of eligible infrastructure to be too narrow?

It is not immediately apparent that there are new technologies that should be included but which would be excluded under the current wording or Article 22. Nevertheless National Grid considers that ideally there should be scope for any such cases to be considered on their merits if and when they appear. However this should be achieved via an appropriate change to Article 22 itself and it is not appropriate to use guidelines to extend the scope of the Directive to new technologies.

3 Do you consider open season (or comparable) procedures an important tool in assessing market demand for capacity with respect to determining the size of the project applying for exemption, as well as in the subsequent capacity allocation? Should open season (or comparable) procedures be mandatory?

In general yes. However, as noted elsewhere in our response it is essential to look at the relevant market(s), the level of competition between infrastructure facilities and the degree of effective competition downstream. Where there is already effective competition between facilities, and barriers to the development of new infrastructure are low, and there are no dominant players downstream (or if the developer is not itself dominant downstream) then an open season or comparable arrangements would not be necessary and so it should not be a mandatory requirement. However each case would need to be considered on its merits and the guidelines should be sufficiently flexible to allow for this without being overly burdensome.

Where competition is limited or there are other barriers (e.g. there may be instances where for example infrastructure may not be easily duplicated due to issues of planning consent, physical geography etc.) then consideration should be given to providing an open season opportunity to obtain signals on market demand and the appropriate capacity for the project concerned.

4 Should open seasons also be used to allocate equity?

In a competitive market (where others can develop competing infrastructure) the developers of a project should be free to determine who will participate and what equity shares the participants should each have. An open season could be used to identify interest in participation but it is not the only method and should not be a mandatory requirement.

5 Some stakeholders think that Art. 22 should be applied differently to LNG terminals as they may be generally better suitable for enhancing competition and security of supply than other types of eligible infrastructure. What is your point of view on this? If you agree, how should this be reflected in the guidelines?

In a competitive market we believe the regulatory approach should be "light touch". Given this we do not believe there should be any difference in the treatment of LNG. While we note that there are some peculiarities associated with LNG that make the development of appropriate anti-hoarding arrangements more challenging than for some other types of infrastructure we do not believe that this issue can be usefully addressed via the guidelines.

6 Are the described criteria for assessing the effects of an investment in infrastructure on enhancement of competition in gas supply appropriate?

National Grid has a number of concerns regarding the proposed criteria in the draft guidelines.

While we agree that defining the market and assessing the impact of the proposed development on the affected markets is essential we note the following:

- In an already competitive market it will become increasingly difficult to demonstrate conclusively that a new market entrant (in terms of a new interconnector or LNG importation facility or new shippers utilising such infrastructure) will produce a demonstrable increase competition. It would be unfortunate (to say the least) if a proposed new project in an already highly competitive market did not go ahead because it could not conclusively demonstrate that it passed the "enhancing competition test". It is our view that the key test should be framed in terms of "is there already adequate competition in the market concerned and will that position remain so as a result of the development of the new project". Where this first test is not considered to be met then the question "whether the proposed new infrastructure will enhance competition and security of supply" should then be addressed.

- The criteria listed should not be seen as comprehensive and other additional criteria should not be precluded but in any event these should not in any way extend the scope of the criteria in Article 22 itself.

- The wording of this section of the guidelines implies that the criteria listed are mandatory. This use of all these criteria may not be appropriate in all cases and the phrasing of the guidelines should be amended to allow the assessment criteria to be flexible and appropriate to the individual case.

- (3.2.1.2 (a)): We note that the effects of an investment on competition and the market can be difficult to assess and while the developers can provide information on their own project, information on existing or future competing projects and their response to additional competition is difficult to assess accurately and could constitute little more than speculation. Its value when used to assess an Article 22 exemption request needs to be considered accordingly.

- (3.2.1.2 (b)): This seems appropriate.

- (3.2.1.2 (c)): As noted in relation to 3.2.1.2 (a) above, many of the items listed will be very difficult to assess with great certainty or accuracy. Different parties may have widely differing views and this needs to be recognised. Some of the criteria (e.g. ranking of competitor projects) imply detailed knowledge of competitors, their cost bases and strategies which may well not be available. Ranking should be deleted as it implies that the NRA may make some selection which is wholly inappropriate and beyond the scope of Article 22. The NRA's assessment should only be in relation to whether the project passes the relevant tests.

7 Are the described criteria for assessing the effects of an investment in infrastructure on enhancement of security of supply appropriate?

It is necessary to understand the market(s) concerned. For instance in some markets rTPA exists operators may have a Security of Supply obligation and the cost of these arrangements are funded by the rTPA tariffs for the infrastructure concerned. In other markets, Security of Supply may be left to the market players reacting to the market environment and there are no explicit Security of Supply obligations on parties. As such the draft criteria listed in the Consultation could be used but they should not be regarded as forming a comprehensive list of criteria and the guidelines should be sufficiently flexible that they can accommodate differing market arrangements.

The first sentence in Foot Note 11 (3.2.2) is incorrect. It implies that a regulated investment will provide the same Security of Supply benefits as a merchant investment. While this is true it does not recognise that in environments (such as the UK) where regulated investment in new infrastructure such as LNG importation, storage, or interconnectors is not practical then a merchant approach with an Article 22 exemption represents the only practical option for progressing the investment on a commercial basis. As such an exemption from Article 22 may be the only way that the investment will take place to enable an enhancement of SoS.

8 Are the described criteria for the risk assessment appropriate?

The criteria seem reasonable although they will need to provide sufficiently flexible to accommodate individual projects. It is worth noting that the final bullet point ion 3.2.3 is of most relevance to the UK where such investments are undertaken on a competitive basis with investors taking the risk rather than projects being underwritten by consumers via rTPA tariffs.

9 Are the described criteria for assessing whether the exemption is not detrimental to competition or the effective functioning of the internal gas market or the efficient functioning of the regulated system to which the infrastructure is connected appropriate?

National Grid agrees that the criteria listed are relevant, it is not clear if these are comprehensive and so there should be sufficient flexibility to ensure individual projects can be appropriately assessed. Where additional internal network capacity is needed to accommodate a new project (in order that unacceptable levels of congestion are not generated) then National Grid agrees that the cost of providing the necessary system reinforcements needs to be charged cost reflectively to those causing them.

10 To what extent should consultations with neighbouring authorities be done?

National Grid's view is that where competition is present in the delivery of infrastructure then regulation should generally be "light touch" and the involvement of neighbouring authorities should only be necessary in the case e.g. of interconnectors where there is the potential for a material impact on the neighbouring system.

11 Parts 3.3.1.1 and 3.3.1.2 of the proposed guidelines deal respectively with partial and full exemptions. Do you consider the described decisions (partial/full exemption) appropriate in safeguarding the goal of Directive 2003/55/EC in making all existing infrastructure available on a non-discriminatory basis to all market participants and safeguarding the principle of proportionality?

National Grid considers that the availability of partial and full exemptions provides sufficient flexibility and should be applied to each project on its merits.

12 Do you believe that Art 22 exemptions should also benefit incumbents or their affiliates? If yes in what way and to what extent?

It is difficult to see how any project being developed by an incumbent Vertically Integrated Company or their affiliates could pass the tests contained within Article 22 regarding enhancing competition, not being detrimental to competition, and the effective functioning of the internal market etc. However, each case should be considered on its merits and if the tests are met then exemptions should not be precluded.

13 Do you agree that under certain circumstances, deciding authorities should be entitled to review the exemption? How can it be assured that this does not undermine the investment?

It is essential that developers, investors and users (including in the case of LNG, suppliers) can see a stable (ideally light touch) regulatory regime if they are to be confident regarding the high levels of both upstream and downstream investment that will be needed to assist the development of the internal market and to secure Europe's energy supplies into the future. An essential feature of any regime therefore is that it does not allow the reopening of historic decisions except under exceptional circumstances.

It would be essential that the threshold at which a regulatory review was initiated was suitably high and was well understood prior to investment decisions being taken. Only a deliberate or reckless material breach of one of the exemption criteria could be considered grounds for a review.

Yours sincerely

[By e-mail]

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