Mrs. Fay Geitona
Secretary General
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25 January 2008

Dear Mrs. Geitona

BG Group Response to ERGEG Public Consultation on Draft Guidelines of Good Practice on Third Party Access for LNG System Operators (GGPLNG).

BG Group welcomes the opportunity to comment on ERGEG's Draft Guidelines of Good Practice on Third Party Access for LNG System Operators. BG Group ("BG") is active in gas exploration and production in both the UK and Norwegian sectors of the North Sea. BG supplies approximately 6% of UK gas demand, and is an active participant in the UK wholesale market, and at the Zeebrugge and TTF hubs. BG is also active in the LNG market with shares in various upstream liquefaction plants, as well as equity and capacity in the Dragon LNG terminal currently being built in the UK. BG is also developing the Brindisi LNG project in Italy.

We have the following general comments:

- We welcome the overall approach that the Guidelines set out a series of principles for governing regulated third party access to LNG terminals. Such an approach will enable National Regulatory Authorities ("NRAs") to take account of the specific conditions in their own jurisdictions. For reasons set out below we believe too prescriptive an approach would be counter-productive.
- We believe that the Guidelines should apply to regulated LNG terminals only. Any move to make the Guidelines to apply automatically to terminals applying for an exemption, or to terminals that already have exemptions, would undermine the benefits of the Article 22 exemption mechanism. This mechanism allows regulators to approve exemption requests on a case by case basis, and tailor exemption regimes to the requirements of the relevant market and project. Automatic application of the guidelines would undermine this, and could therefore lead to exemption regimes that were unnecessarily burdensome in competitive markets. Application of the guidelines to terminals that had already received an exemption would create unnecessary regulatory uncertainty, and could effectively change the terms on which an exemption was granted. This would undermine investor confidence in the European regulatory regime.
- Access to downstream networks is more important than access to LNG terminals themselves in enabling competition in European gas markets, and indeed the ability of different players to access LNG terminals. For example market players who have LNG will be less interested in bringing cargoes to European LNG terminals if they then have

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difficulty in entering the pipeline grid. It is notable that the country which has greatest success with new terminal projects in recent years is the UK, where access to the grid is not an issue. The three phases of the Isle of Grain terminal, and the Dragon and South Hook terminal projects have been supported by a range of different players. BG believes a key reason for this is the ability of such players to access the wholesale and retail markets because of ease of access to the pipeline network. By contrast the ability to move gas across many European networks and hence to markets is challenging because of high levels of contractual congestion.

- Utilisation of LNG terminals is likely to be as much determined by conditions in the wider LNG market, as by rules governing LNG terminals. There is an excess of terminal regasification capacity over liquefaction capacity which means there will be less than 100% utilisation of LNG terminals on average. LNG cargoes will be drawn to those markets which pay the highest price. Regulators should take this into account when monitoring use of LNG terminals.
- In setting the rules governing LNG terminals regulators need to take into account the technical factors and market context for the relevant terminals. Regulators also need to take account of how other elements of their regulatory frameworks interact with that for LNG terminals. For this reason we believe the Guidelines should avoid being too prescriptive. Rather the test should be how effective the local rules governing terminals are in preventing market distortion, enabling new investment in terminals, and enabling LNG players to bring LNG to European markets.

Detailed answers to the various questions are below.

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?

The best way to conciliate TPA / harmonisation and investment is to continue to enable new projects to apply for exemption under Article 22 as this has been shown to encourage investment. However such exemptions should be granted on a case by case basis and subject to meeting the criteria in the Gas Directive. For LNG terminals that are regulated, the technical differences and market contexts of LNG terminals need to be taken into account. Regulators should also take care that regulation does not needlessly undermine the rights of primary capacity holders unless there is clear evidence of anti competitive behaviour or market distortion.

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.)?

Regulators are, of course, free to take into account the Guidelines when setting the terms of an exemption for new projects. However, for the reasons stated above, we do not believe that the Guidelines should apply automatically to terminals seeking exemptions, because of the need to take into account relevant market conditions.

For example regulators should take into account the market context when considering UIOLI regimes. Anti-hoarding mechanisms are necessary in order to protect against anti competitive behaviour and market failure. In the case where LNG terminals and their capacity are controlled by dominant incumbents then stricter UIOLI conditions may be required in order to encourage the development of competition and market opening. Conversely, where the capacity is held by an undertaking with no market power, any under-use of that capacity is unlikely to amount to “hoarding” in the sense envisaged by competition law, with the result that a lighter touch could be envisaged. This could be the

case where a terminal has received an exemption and met the competitive tests described in the Gas Directive. In such a case a UIOLI regime would act as a "safety net" only. It is conceivable that such a terminal is under used, not because of deliberate hoarding by the capacity holders, but because of the lack of availability of LNG cargoes.

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 services. 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?

The attractiveness of unbundled products is likely to be limited because of the interdependent nature of the elements of LNG terminal capacity (berthing slot, storage, send out / regasification). For example, a player with an LNG cargo is not likely to find a berthing slot without storage or regasification capacity attractive because of the practical problems this will raise.

Regulators also need to take into account the "knock on" effects that sale of unbundled capacity may have on primary capacity holders. For example if a LNG cargo owner buys one berth slot with a limited amount of associated storage and send out capacity, but then fails either to deliver his cargo on time, or send out his gas within a given time frame, this can have adverse consequences on the shipping schedules of the primary capacity holders if they have to delay unloading of their cargoes because of the unavailability of the jetty or lack of space in the tanks.

For similar reasons BG believes the attractiveness of interruptible products is likely to be limited. It is unlikely that an LNG shipper will want to schedule a cargo to deliver to an LNG terminal with the risk that he may not be able to do so at the last minute.

For the above reasons BG is unconvinced about the practicality of not bundled or interruptible products. If such products are to be offered, BG believes that the GGPLNG should be less prescriptive and that national regulators need to take account of the technical and market conditions applying to individual LNG terminals.

VII. The GGPLNG recommend that standard bundled services are defined after market consultation, especially concerning the flexibility included. In line with that, they emphasise 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?

BG agrees with the above approach. The market should be free to deliver innovative products to meet demand rather than be subject to the imposition of prescriptive solutions.

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?

Regulators need to take into account how a regulated terminal will be funded. For example, if the terminal offers short term capacity services and this leads to an under-recovery of revenue for the terminal, consideration needs to be given as to how the terminal will recover the revenue shortfall.

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?

For regulated terminals there should be clear capacity allocation procedures and rules that enable competition, and which are non discriminatory and transparent.

As noted above the excess of regasification capacity over liquefaction capacity should encourage a secondary market. Utilisation of a terminal will be at least partly determined by other factors such as the prices different markets are prepared to pay for LNG.

We do not believe that the GGPLNG should be more prescriptive regarding procedures to manage congestion in LNG terminals, and in particular anti hoarding or Use it or Lose it ("UIOLI") measures, for the reasons set out below. Rather than have a "one size fits all" approach the test should be how effective the relevant rules for each terminal are in preventing anti-competitive behaviour and market failure.

a) The technical parameters of each terminal are different

Terminal capacity consists of three different but inter-dependent elements, namely berthing slots, LNG storage tank capacity and vaporisation / send out. Capacity "hoarding" can only take place in the context of the available capacity in different parts of the terminal (i.e. capacity for berthing, tank storage, vaporisation, send out etc). A capacity holder can only be said to be "hoarding" where the lack of use of the terminal is attributable to deliberate under-use of the total available capacity rather than constraints imposed by the technical parameters.

Each UIOLI regime therefore needs to be tailored to the individual design and constraints of the relevant terminal. Therefore the imposition of uniform standards of UIOLI based on standardised definitions of capacity and unused capacity is not appropriate.

b) Regulators should take into account the market context when considering UIOLI regimes.

Anti-hoarding mechanisms are necessary in order to protect against anti competitive behaviour and market failure. In the case where LNG terminals and their capacity are controlled by dominant incumbents then stricter UIOLI conditions may be required in order to encourage the development of competition and market opening.

Conversely, where the capacity is held by an undertaking with no market power, any under-use of that capacity is unlikely to amount to "hoarding" in the sense envisaged by competition law, with the result that a lighter touch could be envisaged. This could be the case where a terminal has received an exemption and met the competitive tests mentioned above. In this case a UIOLI regime would act as a "safety net" only. It is conceivable that such a terminal is under used, not because of deliberate hoarding by the capacity holders, but because of the lack of availability of LNG cargoes.

c) Ill designed UIOLI can be counter productive

UIOLI regimes which unduly punish primary holders of capacity for non use of capacity could undermine the functioning of the gas market, and deter investment. As with (b) above regulators need to take account of the market context.

For example a regime in which a holder risks losing capacity in the future if he does not make use of capacity today, is likely to be counterproductive and distort competition. For example, an owner of cargo with a choice between two or more LNG terminals will, under normal competitive conditions, take the cargo to the market where it is most valued (i.e. where the price for the cargo is higher). This is pro-competitive and underscores the European Commission's recent success in prohibiting restrictions on destination flexibility for shippers. However, if the cost of not using one of the terminals was artificially high (for example if the shipper risks losing capacity in a terminal in future as a result of not making use of the terminal on this occasion) then the shipper will be restricted to choosing that terminal. This constitutes an artificial distortion on trade within the EU and prevents the effective development of competitive downstream markets.

Another example would be where primary capacity holders are required to release capacity on terms which would distort the terms of trade between the primary capacity holders and those using UIOLI capacity. For example if primary capacity holders in terminal had to give a long notice period for unused capacity, and were not allowed to have a reserve price for the sale of that capacity, it might encourage third parties to try and pick up UIOLI capacity cheaply rather than sell cargoes to the primary holder. In addition there is an option value associated with the ability to send cargoes to different LNG terminals. A long notice period takes this option value away from the primary capacity holder.

Depending on the rules governing the use of the terminal this could have several adverse effects. Where the implicit value of the terminal capacity is high, because of the attractiveness of the local gas market in price terms compared to other gas markets, a situation where a third party could pick up the capacity cheaply would simply be a transfer of value from the primary holder to the third party. It would not impact the likelihood of LNG coming to that terminal and therefore could not be seen as preventing hoarding of capacity.

In a circumstance where the primary holder was unable to set a reserve price which led to a third party buying the capacity for less than the primary holder had paid for it, this could lead to a problem of cross subsidisation. If the primary holder was still liable for the original tariff then the primary holder would be cross subsidising the third party. If the primary holder was no longer liable for the tariff, then the terminal would face a revenue short fall and either the terminal or those who paid for the shortfall could be cross subsidising the third party.

Either of these situations could have adverse impacts on the ability to finance new terminals. Primary capacity holders will be less likely to sign up for capacity rights if they believe they will be at a competitive disadvantage by doing so.

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?

Bundled capacity (the combination of berthing slot, storage capacity and regas / send out capacity) is clearly more useful than unbundled capacity for the practical reasons explained in our responses above. For this reason primary capacity holders will have booked bundled capacity. It would not be sensible if the sale of unbundled capacity made the terminal capacity less attractive by undermining bundled capacity rights, and thereby limited the ability of capacity holders to use the terminal.

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?

Please see our comments on Question XIV, in particular about how ill designed UIOLI can be counter productive.

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?

- 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?

Regulators need to take into account market conditions when assessing the use of capacity. For example a lack of cargoes being delivered to an LNG terminal may simply be an indicator that other markets are more attractive. For example in recent months the UK market price has been higher than the US Henry Hub price. However the prices paid by some Asian buyers have been higher still, which has attracted cargoes there. Similarly, if the send out capacity of a terminal is flexible enough, it may not make sense to send out gas at weekends when prices tend to be lower in wholesale competitive markets in order to have more gas to send out when prices are higher during the week. It is therefore better that NRAs evaluate the utilisation of terminals.

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?

We agree that the GGPLN should content themselves as a set of general principles as laid out in Section 5.3. This will enable regulators to adapt their rules as market conditions evolve.

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?

We do not believe that the GGPLNG should be more prescriptive on notice periods regarding unused capacity. The length of notice period has a direct bearing on the value of the capacity to the primary capacity holder. The longer the notice period, the greater the potential loss in value for the primary holder, since he no longer has the ability to decide to bring cargoes into that LNG terminal if relative market prices change. Therefore any definition of the notice period must be consistent with the other terms and conditions for governing the primary capacity holders' rights, including the price that the primary capacity holders pay for their rights.

In setting any notice period the NRA should also take into account the other factors mentioned in the responses above, namely the nature of the terminal and the market context. For example the NRA could take account of the ability of third party ships to divert to the terminal in question which would involve analysis of the terminal's location relative to liquefaction plants and LNG shipping routes. The NRA would also need to take into account the existence of other terminals in the market; where there are several terminals one could expect that capacity holders might compete to sell capacity that they do not need. As mentioned elsewhere NRAs may need to take into account the market position of the capacity holders.

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 underutilised capacity should be released? Would a less constraint mechanism be preferable?

We do not believe that the GGPLNG should be more prescriptive. The principles regarding the release of underutilised capacity need to take account of the relevant circumstances, both market and technical, affecting the terminal. NRAs need to be aware that these circumstances may change as the market for gas in Europe, and the world LNG market, evolves. The test for rules governing unused is how effective they are in preventing market failure or distortion whilst creating an environment which encourages market players to bring LNG to the European market.

Should you have any queries please do not hesitate to contact me on ++ 44 118 929 3442 or at alex.barnes@bg-group.com.

Yours sincerely

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