ExxonMobil International Limited
MP 42, ExxonMobil House
Ermyn Way
Leatherhead
Surrey KT22 8UX
01372 223166 Telephone
01372 223160 Facsimile
ian.r.trickle@exxonmobil.com

Ian Trickle
Advisor Europe Regulatory

ExxonMobil
Gas & Power
Marketing

1 May 2008

Draft Guidelines on Article 22 -
An ERGEG Consultation Paper

European Regulators' Group for Electricity and Gas
28 rue le Titien
1000 Bruxelles
Arrondissement judiciaire de Bruxelles

Dear Sirs,

ExxonMobil welcomes the opportunity to comment on this consultation. The form of our response includes some introductory remarks, responses to the specific questions raised in the consultation and further comments on the topics "Duration of Contracts" and "Mechanisms for Management and Allocation of Capacity"

Introductory Remarks

ERGEG states in its Introduction that:

1. the guidelines should provide a *"harmonised and transparent framework for competent authorities when deciding on exemption procedures"*, that

2. it has prepared the consultation as a reaction to the Commission's *"invitation for submitting early comments on the new Gas Infrastructure Investment Regulation (NGIIR)"* and,

3. that the draft guidelines arising from the consultation are "*subsequently to be embedded in an overall ERGEG paper"*

The achievement of effective*" harmonisation"* across Europe will be no easier in the application of Article 22 than it has been elsewhere and we believe that this step has its place somewhere further down the queue of priorities. It is more important that regulatory competencies and independence are allowed to develop further, on the back of base operations regulation (i.e. existing infrastructure). Article 22 as it exists today, along with

DGTren's current interpretative note[1] on its application has found unique success in the enablement of major new investments. ERGEG has not explained in any detail why it believes that the proposed guidelines represent an improvement and the question therefore remains "why change"?

We agree that there should be a *"transparent framework"* available to guide both investors and the regulatory authorities. As a matter both of practicality and efficiency any form of guidelines must allow an exemption application to be reviewed on its own merits (the 'case by case' requirement of the Directive), should be flexible enough to make allowance for the different national market contexts of each Member State and be able to accommodate the variety of project models.

ERGEG's reference to a "new" Gas Infrastructure Regulation (NGIIR) is confusing – there is no mention of work on this area in ERGEG's 2008 Work Program and we are not aware of any developments on this since the end of 2006. It is not at all clear what the *"overall ERGEG paper"* is intended for and what else is to be included in that paper. We would welcome any clarification ERGEG can give on their statements and to advise on any changes it is making to its 2008 Work Program in relation to Article 22 or related matters.

Changes to the guidance now, in the absence of a clear long term direction and actual operational experience create a new risk of failure at implementation and arbitrary or inadvertent exclusion of efficient projects. Any new guidance should be struck at the minimum level of additional clarification necessary, should not seek to extend the provisions of Article 22, and should be thoroughly tested (years) in operation before additional regulations are considered.

As far as long term direction is concerned there is much debate in Europe about the potential for discrimination when there are facilities operating on both a regulated and exempt basis. There are alternative models that Europe could select (post transition) in a fully integrated market: one is the fully regulated TPA model for all major infrastructure, one is a deregulated structure with light touch regulation for certain types of facilities (e.g. LNG terminals) and the last is a fully deregulated structure for all key infrastructure (transmission, storage and LNG terminals).

Assuming that efficient new infrastructure investment is considered essential, that avoidance of unnecessary cost and risk for European consumers remains important, and that deregulation (light touch approach) for some major infrastructure types has not been ruled out as a long term direction, then we would expect that the final form of the guidelines will reflect these. Conditions on the exemption may be employed to manage residual competition (consumer) risk allowing decisions in marginal cases to be exercised in favour of project sponsors. Existing regulated facilities (of the same type) could be deregulated after project payback and transit to the same lighter touch regulation as exempt facilities. Practical regulatory guidance could be given both to encourage investment and simplify operations. For instance Member States could be encouraged not to apply, or to disapply, national 80/20 or 75/25 rules/guidelines that constrain Article 22 applications to partial capacity exemptions. Creating such two tier regimes within an individual facility (such as an LNG terminal)

[1] Note of DG TREN on Directive 2003/55/EC and Regulation 1228/ 2003 in the electricity and gas internal market concerning exemptions from certain provisions of the third party access regime, 30.1.2004.

presents many of the same issues to the operator of that facility as a two tier regime in Europe poses for Europe's regulators.

The alternative fully regulated option socializing all the costs of building new infrastructure will, in our view, turn out to be a more expensive and less efficient choice for the European consumer.

In summary: we believe the current interpretative note of DGTren has worked well and we would prefer it remained unchanged, but accept that some changes may bring additional clarity to the Article 22 review process; any new guidance or criteria should not go beyond "interpretation" and extend the scope of the Directive in any way. Changes should be founded not simply on regulators' experience of the application review process but on reasonable experience of exemptions/conditions in actual operation. The guidelines should be shaped as far as possible by a long term direction for deregulation so that Europe clearly posts its intention to remain competitive. In the case of LNG, Europe's Article 22 already represents the most stringent conditions of any of the global markets for LNG terminal construction (exemption criteria are less in the U.S, India, China, Korea, and Japan). Adding any additional element to approval is unwarranted and may lead to investors shying away from the EU market.

Comments On The Consultation Questions

Q1. 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?

Consistency of application by NRA's relies not only on the guidelines provided but also on the competence of the NRA's and their independence. Hence a replacement of the existing interpretive note will not in itself be a guarantee of consistency and fair treatment. Arguably regulatory competencies should be dealt with first.

Any exemption guidelines must be defined broadly enough to enable the National Regulatory Authorities to apply these locally without risk of conflict in their national market circumstances. This applies to all but may be particularly important for those Member States where rTPA is normally employed. National regulators should not be able to prevent an Article 22 application nor should they be able to resist reviewing such an application. There is of course the option to develop incentives for a project sponsor to operate under the full force of regulated TPA always taking into account the consequences for consumers.

The guidelines must only include guidance (interpretation) that is relevant to Article 22 and *Directive 2003/55/EC and not include or imply additional tests that may arbitrarily reduce the possibility of exemptions. Europe's global competitiveness is at stake.*

The case-by-case approach required under the Directive specifies that consideration may be given to the need to impose conditions regarding duration of the exemption and that when deciding on such conditions the authority shall take account of in particular, the duration of contracts, the time horizon of the project and national circumstances.

Q2 Do you consider the present scope of eligible infrastructure to be too narrow?

Broadly we support the eligibility criteria as described in Section 2.2.

Assuming that the intention is to ensure consistent treatment, we believe that "Essential" and non-Essential facility proposals should be reviewed by applying the same guidelines. Of course the outcomes from similarly conducted reviews in each case might be different and the decision made on, or conditions applied to an exemption might therefore be different – that is a key strength of the case-by case-review.

Q3 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?

We agree with ERGEG that open seasons for allocation of primary capacity cannot be mandatory and their suitability will depend on the particular project under consideration. The decision to conduct an open season must rest exclusively with the project sponsors. The reasons for a decision for or against an open season may reasonably be required for consideration by the regulatory authority responsible for reviewing an exemption application.

For merchant terminals (where the terminal owners have no affiliated interests as a User as a producer or as a transporter) a well structured open season procedure might be a useful mechanism for identification of the level of market interest as well as for the efficient, non discriminatory allocation of primary (initial) capacity. On the other hand such processes increase the lead time required for a project and rarely produces a level of firm interest that matches with an efficient physical design selection or the optimum project timing.

Integrated infrastructure projects may be developed as part of a project that involves an upstream source of supply. In these cases an open season on say an LNG terminal is unlikely to be the preferred route of a project developer, especially if this were thought likely to increase the difficulties in managing the upstream project to schedule and budget.

Q4 Should open seasons also be used to allocate equity?

No, a mandatory process for allocating terminal equity must be avoided – such an additional process will be a further burden on project developers and increase the complexity of business activities to be completed before a final investment decision can be taken. Such a requirement would significantly reduce the likelihood of investment or timely investment.

Such processes would be unprecedented in the global LNG market and as such, could potentially provide an obstacle that might divert investment elsewhere in the world and away from the EU.

Q5 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 is reflected in the guidelines?

LNG terminals enable access by gas supplies sourced from around the world in the form of LNG. International pipelines connect fewer sources to fewer market areas. Pipelines arguably do less to promote supply diversity and competition in the upstream and wholesale market sectors compared to LNG terminals.

However we believe that the contributions to supply diversity and competition can be properly taken account of under the relevant tests and on that basis there is no clear reason to create a special case for treatment of LNG terminals.

It would be possible, however, for Europe to treat LNG Terminals differently on the harmonisation approach chosen. As mentioned above in our introductory remarks, LNG Terminals could be more quickly harmonised on the exempt/light touch regulation approach. LNG terminal ability to connect key external supplies simply demands that a uniform light touch approach is adopted.

Q6 Are the described criteria for assessing the effects of an investment in infrastructure on enhancement of competition in gas supply appropriate?

Broadly we agree the criteria for assessment as listed under Section 3.2.1 but we have concerns in two respects:

State owned producers exercising control over a proposed infrastructure investment will by their very nature be dominant in their own country (refer 3.2.1.b). Hence it would be more appropriate for the exemption review to be focussed on that producer's position in the relevant sector of the market for production and supply and not its position in its own

country. Today, the relevant market for production and supply to Europe is very wide and includes the EEA, Russia, the Caspian, North Africa and LNG from global sources.

We are very concerned about inclusion of any guideline (see 3.2.1.c) that one project might be compared and ranked with another project. "Ranking" implies a central decision-making process that goes beyond an objective application of the Article 22 tests and implies abandonment of the case by case requirement. ERGEG's guidelines must be consistent with allowing the case-by-case approach and there is no justification for introducing a "ranking" guideline. [2]

Q7 Are the described criteria for assessing the effects of an investment in infrastructure on enhancement of security of supply appropriate?

We support the guidelines listed under 3.2.2

Q8 Are the described criteria for the risk assessment appropriate?

Whilst broadly agreeing with the 3.2.3 guidelines we would note that "throughput" may be more or less relevant depending on business model and type of infrastructure. Especially in a global LNG market a throughput assessment in an LNG terminal may need to cover a wide range to account for various market conditions. For merchant facilities throughput is largely irrelevant for financing purposes whereas the terms of capacity contracts will be very important.

Q9 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?

3.2.6.b should not be included as a guideline as any effects here can be overcome by ensuring that the developers of new infrastructure must cover the appropriate level of any consequential transmission expansion required.

Q10 To what extent should consultations with neighbouring authorities be done?

---

[2] T*he purpose of a ranking guideline is not entirely clear. ERGEG's intention may be to enable a regulator to determine priorities for any consequential transmission investment for a connecting facility such as storage or LNG. It would, however, be more appropriate that regulatory authorities and TSO's establish transmission rules that allow infrastructure users to signal their requirements for transmission capacity and to make appropriate commitments to ensure the investment is made. Such market mechanisms shield consumers from the financial consequences of potentially overlapping infrastructure projects, allowing each to proceed, and avoiding any need for a regulatory selection process.*

Clearly for pipeline interconnectors each of the relevant authorities should be involved in the consultation, and we would encourage ERGEG to consider routes for streamlining the process in the interests of efficient decision making and timely investment. Perhaps early on in the process the relevant regulators, on the basis of a preliminary assessment of the investment, could agree whether it would in fact be possible to allow the review to be concluded by only one regulator.

Q11 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??

We agree that the guidelines cannot set a limitation on the range of possible exemption types that could be applied for and/or granted. In the context of Article 22 level investments we strongly urge that ERGEG exercise its influence to encourage the earliest possible abandonment of 80/20 or 75/25 rules/guidelines as these have the potential to eliminate rather than encourage investment and competition.

Furthermore partial capacity exemptions significantly increase business complexity and severely limit any benefits of innovation that might otherwise be available to an operator were his facility completely free of direct regulation. For instance it will be difficult if not impossible to operate a mandated use it or lose design for the regulated portion of capacity whilst being entirely free to design differently for the exempt element. We doubt that there is any appetite amongst the investment community to support projects where an Article 22 exemption is granted only for a part of a facility's capacity.

ERGEG should also consider contract terms as a guideline to match the duration of the exemption.

Q12 Do you believe that Art 22 exemptions should also benefit incumbents or their affiliates? If yes in what way and to what extent?

If the Article 22 tests are considered passed by the application of the procedures under question, then it should not matter whether an incumbent or its affiliates derives some benefit.

Q13 **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?**

We agree with ERGEG that where conditions apply and an owner/operator fails to comply a review of how the non compliance is rectified should take place but with revocation of an exemption only being considered as a last resort.

Section 3.3.1.3 b (duration) proposes that an exemption that is dependent on "market predictions" and can be reviewed after it is granted if such predictions were to change. An investment decision once taken is an irreversible event and to the extent that there is scope for a regulator to review an exemption based on changes in market predictions it would have the effect of inhibiting the availability and cost of finance. We would strongly urge that this guideline be removed.

National Regulating Authorities should be advised to exercise care before initiating a review because a facility has "a negative impact on competition/security of supply" – it would be important only to proceed with such a review if the "negative impact" is attributable to the conduct of the terminal owner/operator and such conduct has resulted in anticompetitive effects.

Furthermore subsequent mergers or acquisitions should not give reason to revisit an article 22 exemption. Conditions for approving mergers and acquisitions are set out in separate merger regulations which provide the relevant regulator with a range of reactions to avoid market dominance.

Additional Comments

We also wish to make comments on two areas where there are no specific questions raised by ERGEG:

1. Duration of Contracts

Prior decisional practice should be included in the guidance, and, according to the Directive the regulatory authorities should consider matching the exemption period to the duration of contracts required. In some cases the contracts may match or be close to the "payback" period but in integrated projects contracts in the upstream element may drive contracting duration across the chain. Arbitrarily limiting exemption duration on the basis of a payback period or on terminal contract duration could therefore have a negative impact on any project but particularly where there is an upstream supply element.

2. Mechanisms for Management and Allocation of Capacity

Whilst it is acceptable for a deciding authority to require an operator to implement appropriate congestion management measures, it would not be appropriate to "impose" them. The

requirement should be that appropriate procedures are put in place prior to the start of commercial operations since allocation, including congestion management, and use it or lose it schemes take considerable time to develop given that they are at least in part related to physical elements of the operation and have to interface with the code of the network operator. "Imposing" implies that the deciding authority will have a direct role in the design of these commercial/operational rules. Our experience has been that the design of such rules is complex requiring significant time (many months, even years) and resources. If an exemption decision were to be dependent on the ex-ante detailed design of such rules, then it is likely that many new projects would not be brought forward in Europe and investors would look to locations where the burdens of participation were much less.

We trust that ERGEG will find these comments helpful and if any clarification is required please do not hesitate to contact us.

Ian Trickle