

**Application by Grain LNG Ltd under section
19C of the Gas Act 1986 for an exemption
from section 19D of the Gas Act 1986**

Ofgem final views

December 2004 273/04

Summary

The new Gas and Electricity Directives¹ introduced, amongst other things, a regulated third party access (RTPA) regime for interconnectors and Liquefied Natural Gas (LNG) import terminals. The Directives allow exemption from RTPA to be given by the relevant regulatory authorities, subject to veto by the European Commission. The Directives set down criteria that have to be met in order to justify such an exemption being granted.

On 12 August 2004, Grain LNG Ltd (GLNG), a subsidiary of National Grid Transco plc (NGT), wrote to Ofgem requesting an exemption under section 19C(2) of the Gas Act 1986 from the application of section 19D of the Gas Act 1986 to the entire proposed capacity of its LNG import facility on the Isle of Grain.

In its application, GLNG explains that its application demonstrates that the Isle of Grain LNG import facility satisfies the criteria set out in section 19C of the Gas Act 1986 for an exemption from section 19D. GLNG suggests that the granting of an exemption should not give rise to any concern for the regulatory authorities and will enable the GLNG facility to deliver significant benefits to the UK and EU in relation to security of supply and competition in gas supply.

On 4 October 2004, Ofgem issued a consultation paper² on GLNG's formal application for an exemption under section 19C(2) of the Gas Act 1986 from the application of section 19D of the Gas Act 1986 in relation to all of the proposed capacity of its LNG import facility on the Isle of Grain. In summary, Ofgem's preliminary view was that all the criteria are met and, as such, this project could be expected to have an overall positive impact on competition and security and diversity of supply for the UK. Therefore, Ofgem's initial view was that an exemption should be granted to the Isle of Grain LNG import facility.

Ofgem has considered the responses received to the consultation on GLNG's formal application in making a decision on whether to grant an exemption to GLNG from the

¹ Directive 2003/55/EC of the European Parliament and of the Council concerning common rules for the internal market in electricity and repealing Directive 96/92/EC; and Directive 2003/54/EC of the European Parliament and of the Council concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC.

² 'Application by Grain LNG Ltd under section 19C of the Gas Act 1986 for an exemption from section 19D of the Gas Act 1986, Initial views', Ofgem, October 2004.

application of section 19D of the Gas Act 1986 in respect of its LNG import facility on the Isle of Grain. Ofgem remains of the view that all the exemption criteria are met and therefore the Authority has decided to give GLNG an exemption in respect of the entire capacity of the proposed Isle of Grain LNG import facility on the Isle of Grain under section 19C(5) of the Gas Act 1986 from the application of section 19D of the Gas Act 1986. This exemption order is set out in Appendix 1 of this document.

The European Commission has two months in which it can veto a decision by the relevant authority in a Member State to grant an exemption, or request that the regulatory authority amend its decision.³

³ This two month period may be extended by one additional month where additional information is sought by the Commission.

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1. Introduction

Background

- 1.1. The new Gas and Electricity Directives introduced, amongst other things, an RTPA regime for interconnectors and LNG import terminals. The Directives allow exemption from RTPA by the relevant regulatory authorities, subject to veto by the European Commission. With respect to LNG import terminals, the new EU Gas Directive was transposed into GB law with the coming into force of the Gas (Third Party Access) Regulations 2004 on 26 August 2004. Ofgem therefore now has formal powers to grant exemption from the RTPA requirements for LNG import facilities, as set out in sections 19C and 19D of the Gas Act 1986.
- 1.2. The Directives set down criteria that have to be met in order to justify such an exemption being granted. The criteria contained in 19C(7) of the Gas Act 1986 relating to an exemption for an LNG import facility are:
 - (a) the facility or (as the case may be) the significant increase in its capacity will promote security of supply;
 - (b) the level of risk is such that the investment to construct the facility or (as the case may be) to modify the facility to provide for a significant increase in its capacity would not be or would not have been made without the exemption;
 - (c) the facility is or is to be owned by a person other than the gas transporter who operates or will operate the pipeline system connected or to be connected to the facility;
 - (d) charges will be levied on users of the facility or (as the case may) the increase in its capacity;
 - (e) the exemption will not be detrimental to competition, the operation of an economically efficient gas market or the efficient functioning of the pipeline system connected or to be connected to the facility; and

- (f) the Commission of the European Communities is or will be content with the exemption.

1.3. It should be noted that it is against these exemption requirements that Ofgem will assess any application for exemption. Whilst there may appear to be some minor differences between the criteria in the Gas Act 1986 and those contained in the new Gas Directive, Ofgem does not consider that there are any material differences between the two sets of criteria.

DTI/Ofgem exemption policy

1.4. In June 2003, the Department of Trade and Industry (DTI) and Ofgem issued a joint consultation document concerning new regulations to apply to LNG facilities and interconnectors.⁴ This document set out the initial views of the DTI/Ofgem regarding the regulatory regime for interconnectors and LNG facilities. In addition to a quantitative competition analysis, DTI/Ofgem identified three areas that would be minimum requirements for an exempt regime:

- ◆ effective capacity allocation in terms of an initial offer of capacity to market (though under specific circumstances this condition might be loosened);
- ◆ effective mechanisms to ensure that capacity is not hoarded i.e. Use It or Lose It (UIOLI) arrangements; and
- ◆ information provision requirements relating both to the regulator and potentially also to market.

1.5. In November 2003, the DTI and Ofgem issued final views in relation to the new Directives and the resulting regulatory regime.⁵ By and large, the final views document confirmed, and clarified, the position set out in the initial

⁴ 'LNG facilities and interconnectors, EU legislation and regulatory regime, DTI/Ofgem initial views', DTI/Ofgem, June 2003.

⁵ 'LNG facilities and interconnectors, EU legislation and regulatory regime, DTI/Ofgem final views', DTI/Ofgem, November 2003.

views document. DTI and Ofgem expanded upon grounds for withdrawal of an exemption:

- ◆ breach of exemption criteria;
- ◆ breach of competition law;
- ◆ bankruptcy; or
- ◆ mergers / acquisition activity.

1.6. At the time, there were several potential projects that were moving to financial close prior to the Directives becoming transposed into GB law. Project developers requested early guidance as to whether they could expect their particular project to be exempt from RTPA. Ofgem said that while it would be prepared to give such guidance, any guidance would need to be informed by consultation on a case-by-case basis. Any such consultation would be on the basis of a draft application for exemption prepared by the relevant infrastructure developer. Ofgem indicated that while it would aim to ensure, as far as possible, that any potential guidance that it issued gave comfort as to the likely regulatory treatment of particular infrastructure, any such guidance issued would also be constrained to a significant extent by necessary legal caveats.

1.7. Ofgem received draft applications for exemption in respect of three projects. In each case, Ofgem consulted upon, and issued regulatory guidance to, each project. The first application was from Gastransport Services (GTS) for the proposed Balgzand Bacton pipeline project (BBL).⁶ The second application was received from Qatar Petroleum and ExxonMobil for the proposed South Hook LNG import terminal at Milford Haven in Wales.⁷ The third application

⁶ 'Gastransport Services, Draft application for an exemption for the Balgzand Bacton Pipeline project (BBL), Final views', Ofgem, December 2003.

⁷ 'Qatar Petroleum and ExxonMobil, Draft Gas Directive Exemption Application for an LNG Terminal at Milford Haven, Final views', Ofgem, February 2004.

was received from Dragon LNG Ltd for the proposed LNG import terminal, also at Milford Haven.⁸

- 1.8. In each case, Ofgem expressed the view that the application for exemption would be likely to meet each of the exemption criteria set out in the relevant EU legislation. In these documents, Ofgem stated that once legislative authority was granted to Ofgem in respect of the ability to give exemptions to LNG facilities from the RTPA requirements, Ofgem would expect to undertake a formal consultation process in respect of formal applications it received for exemption.
- 1.9. In each case, Ofgem's views were submitted to the European Commission who indicated general support for Ofgem's position.
- 1.10. GLNG did not submit an application for written regulatory guidance. Its decision to invest was taken ahead of the DTI/Ofgem policy on the issuing of written regulatory guidance. GLNG did however receive verbal guidance from the DTI and Ofgem that it could expect to be exempt as and when formal powers became available.

Formal application by Grain LNG Ltd

- 1.11. On 12 August 2004, GLNG, a subsidiary of NGT, wrote to Ofgem formally requesting an exemption under section 19C(2) of the Gas Act 1986 from the RTPA requirements set out in section 19D of the Gas Act 1986 to all of the proposed capacity of its LNG import facility on the Isle of Grain. The public version of GLNG's application for exemption can be found on the Ofgem website.⁹

Ofgem's initial views

- 1.12. On 4 October 2004, Ofgem issued a consultation paper on GLNG's formal application for an exemption. Ofgem's initial view was that all the criteria

⁸ 'Dragon LNG Ltd, Draft application for an exemption for the Milford Haven LNG import terminal, Final views', Ofgem, June 2004.

for the granting of an exemption have been satisfied and that it would be appropriate to grant the exemption. Ofgem invited responses on Ofgem's initial views and on the draft exemption order to be received by close of business 1 November 2004.

Respondents' views

- 1.13. Ofgem received six responses to the consultation. Two of these responses were marked as confidential. The non confidential responses can be found in full on the Ofgem website. Of the non confidential responses, three agreed with Ofgem's initial view that all the criteria for the granting of an exemption have been satisfied and that it would be appropriate to grant the exemption and the remaining respondent requested further analysis. Respondents' views are discussed in Chapter 2.

Ofgem's final view

- 1.14. Ofgem has considered respondents views in making a decision on whether to grant an exemption to GLNG from the application of section 19D of the Gas Act 1986 to its LNG import facility on the Isle of Grain. Ofgem considers that all the exemption criteria are met. Ofgem's final views are discussed in more detail in Chapter 2.
- 1.15. Ofgem has recently clarified the process by which an exemption decision should be notified to the European Commission. If Ofgem decides that the exemption criteria have been met then the Authority will grant the exemption. Ofgem will then submit the exemption decision to the European Commission for it to make its decision as to whether Ofgem's decision should be withdrawn or amended.
- 1.16. Since it is Ofgem's view that all the exemption criteria are met, the Authority has decided to give GLNG an exemption under section 19C(5) of the Gas Act 1986 from the application of section 19D of the Gas Act 1986 to the entire

⁹ www.ofgem.gov.uk, under "Europe" area of work.

proposed capacity of its LNG import facility on the Isle of Grain. This exemption order is set out in Appendix 1 of this document.

Way forward

- 1.17. This final views document, together with the exemption order and all supporting documents will be submitted to the European Commission. The European Commission has two months in which it can veto a decision by the relevant authority in a Member State to grant an exemption, or request that the regulatory authority amend its decision.
- 1.18. If you wish to discuss any matters in this document, please contact Adam Higginson on 020 7901 7432.

2. Ofgem's decision

- 2.1. Ofgem's consultation document set out the arguments presented by GLNG in its formal exemption application request as to why it considered that it met the various requirements of section 19C of the Gas Act 1986. This document also set out why Ofgem was minded to exempt the Isle of Grain LNG import facility from the requirements of section 19D of the Gas Act 1986.
- 2.2. Ofgem received six responses to the consultation, two of which were marked as confidential. This chapter provides a summary of respondents' views and provides Ofgem's final views.

Ofgem's analysis of whether the exemption conditions are met

(a) the facility or (as the case may be) the significant increase in its capacity will promote security of supply

Ofgem's initial view

- 2.3. Ofgem considered that the Isle of Grain facility should interact appropriately with existing arrangements that help to ensure security of supply. Ofgem considered that the addition of a new source of gas will be beneficial for security of supply. Ofgem generally considered that efficient investment in LNG can significantly increase the diversity of import supply sources. In addition, Ofgem considered that the Isle of Grain facility should be beneficial for diversity of supply by introducing a new entry point. Ofgem therefore expected this requirement to be met.

Respondents' views

- 2.4. One respondent considered that the more competing sources of wholesale gas entering the UK gas market via different entry routes the more security of supply will be enhanced.

Ofgem's final view

- 2.5. Ofgem's final view is that the Isle of Grain facility will promote security of supply.

(b) the level of risk is such that the investment to construct the facility or (as the case may be) to modify the facility to provide for a significant increase in its capacity would not be or would not have been made without the exemption

Ofgem's initial view

- 2.6. Ofgem noted GLNG's assertion that without the expectation of an exemption the income assurances required to make the project viable would not have been sufficient when taking into account the significant risks associated with the project and NGT's view of the risk-reward balance.
- 2.7. Ofgem explained in the initial views document that Ofgem did not receive formal powers to grant exemptions until changes were made to the Gas Act 1986 on 26 August 2004. In the interim, in order to increase regulatory certainty for infrastructure project developers, DTI/Ofgem confirmed in the final views document published in November 2003, which related to the matter of exemptions more broadly, that Ofgem was prepared to consider applications from infrastructure project developers who were seeking early guidance on possible exemptions. The main investment decision relating to the conversion phase of the project for the Isle of Grain was made in May 2003. Therefore, at this time, the facility of seeking informal guidance was not available to GLNG and there was no route available for investors in the project to seek written guidance on a possible exemption.
- 2.8. Ofgem explained in the initial views document that given the advanced nature of the investment (ie. planned delivery early 2005), the DTI and Ofgem had given verbal reassurances to GLNG that it was likely that an exemption would be forthcoming if the facility was developed consistent with

criteria in the proposed Directive. Moreover, Ofgem's view was subject to GLNG demonstrating that all capacity had been offered to the market, an effective Use-It-Or-Lose-It (UIOLI) regime was in place for access to the LNG terminal and appropriate information gathering powers were in place. This was then reflected in GLNG's structuring of the project.

- 2.9. Ofgem noted GLNG's suggestion that the assessment as to whether this test is met or not needs to be applied at the point the investment decision was taken and not at the time the exemption application is submitted. Ofgem agreed that while the assessment is being made now, Ofgem would consider the application against the position facing the NGT board at May 2003.
- 2.10. On this basis, Ofgem's initial view was that the initial phase of the project would not have been built without the comfort that an exemption could be forthcoming. Ofgem was also of the preliminary view that an exemption is necessary for the second phase of capacity at the Isle of Grain LNG import facility to proceed. Having taken into account GLNG's comments, Ofgem considered that level of risk is such that the investment to construct the Isle of Grain facility would not have been made without the exemption.

Respondents' views

- 2.11. One respondent considered the initial capacity for the Isle of Grain does not pass this test as the decision to invest has already been taken. This respondent also suggested that whilst other projects sought preliminary views from Ofgem, GLNG did not follow this route for either phase of the project.
- 2.12. One respondent explained that during the 'open season' process for Isle of Grain, Ofgem and the DTI were finalising the policy and procedure for granting exemptions that would be in place once the new Gas Directive became transposed into GB law. This respondent explained that consequently both NGT and the throughputters were compelled to make significant investment decisions prior to the availability of the early guidance process and the timing of these decisions was necessary in order to deliver new gas supplies to the UK by early 2005. This respondent further explained

that Ofgem's verbal assurances regarding the likelihood of exemption, combined with the commitment to structure the project in order to satisfy the conditions for obtaining an exemption provided them with the comfort necessary to make its contractual commitment to the capacity.

Ofgem's final view

- 2.13. Ofgem notes the comments of one respondent that whilst other projects sought preliminary views from Ofgem, GLNG did not follow this route for either phase of the project. Ofgem reiterates its previous comment that at the time the main investment decision for the Isle of Grain project was made the facility for seeking informal guidance was not available to GLNG and there was no route available for investors in the project to seek written guidance on a possible exemption. Ofgem remains of the view that this requirement has been met.

(c) the facility is or is to be owned by a person other than the gas transporter who operates or will operate the pipeline system connected or to be connected to the facility

Ofgem's initial view

- 2.14. Ofgem considered that it is clear that the Isle of Grain LNG import facility is legally separate from Transco, the system operator. Ofgem therefore expected this requirement to be met.

Respondents' views

- 2.15. One respondent requested clarification as to how the necessary ring-fencing will be monitored both internally by NGT and externally by Ofgem.

Ofgem's final view

- 2.16. As referred to in GLNG's application, Transco has a number of Licence Conditions and obligations under the Gas Act 1986 that should operate to ensure that no unfair commercial advantage is conferred on GLNG. In addition, Transco has relevant Codes of Conduct to further reinforce the

relevant separation of GLNG and Transco activities. Ofgem would investigate any potential breach of Transco's Licence Conditions or obligations in the Gas Act 1986 as a result of Ofgem's regular market monitoring and ongoing market surveillance. Ofgem considers that this requirement has been met.

(d) charges will be levied on users of the facility or (as the case may be) the increase in its capacity

Ofgem's initial view

- 2.17. Ofgem considered that on the basis that the throughputters will be charged an annual charge for the use of GLNG capacity, this exemption criterion is likely to be met. Ofgem's initial preference was that the charges were published. However, Ofgem noted that GLNG has explained that its throughput charges, while available to Ofgem, are commercially confidential. Therefore, at this point, Ofgem did not propose that GLNG publishes its throughput charges but welcomed respondents' views on this issue.

Respondents' views

- 2.18. One respondent was content with Ofgem's proposal not to require throughput charges to be made public as long as these charges are provided to Ofgem such that any dispute or challenge can be resolved by Ofgem. Another respondent fully supported not requiring publication of throughput charges as competition in both the commodity market and the secondary capacity market should promote price transparency.

Ofgem's final view

- 2.19. Under the requirements of the exemption order GLNG could be required to provide Ofgem with such information as throughput charges. Therefore, Ofgem will have access to the necessary information to investigate any disputes raised by market participants over tariffs should such disputes arise. Ofgem remains of the view that GLNG should not be required to publish its throughput charges and considers that this requirement has been met. Public

information disclosure requirements are discussed further below under the draft exemption order section.

- 2.20. As charges will be levied on all users of the facility, Ofgem considers that this requirement has been met.

(e) the exemption will not be detrimental to competition, the operation of an economically efficient gas market or the efficient functioning of the pipeline system connected or to be connected to the facility

Ofgem's initial view

- 2.21. Ofgem considered and broadly agreed with GLNG's views as to the competitive nature of the UK market. In respect of GLNG's quantitative analysis provided by Frontier Economics, Ofgem made several observations. In summary, Ofgem's initial view was that the Isle of Grain project should provide material benefits to upstream markets and that the project should have no material adverse effect on downstream competition. Ofgem considered that this criterion is likely to be met, given that the project is not detrimental to competition.
- 2.22. Ofgem noted that GLNG agreed to conduct an open season in which parties were invited to express an interest in capacity from the first phase of the import terminal and that GLNG is holding another open season process for the second phase capacity. Ofgem also noted that GLNG has agreed to implement anti-hoarding measures and the publication of relevant information to enable the market to make considered decisions with regard to secondary trading. GLNG's decision to hold an initial and second open season, as well as its decision to develop a website that is designed to facilitate secondary trading and sub-letting by the primary capacity owners was an important part of Ofgem's assessment of this exemption application.
- 2.23. Ofgem noted that Transco has replaced its operating margins and system support requirements at the Isle of Grain with the Transco Services Agreement. Ofgem explained that in contracting for these services, Transco must bear in mind that it has a statutory obligation to develop an economic

and efficient system, and also that it has a licence obligation to ensure that its transportation business shall not give or receive any cross subsidy to or from any other business of Transco or of an affiliate or related undertaking of it (Standard Condition 41 (Prohibition of Cross-Subsidies)). Ofgem stated that it has not approved the Transco Services Agreement or any change in the funding for operating margin and system support services that may result from these new contractual arrangements.

Respondents' views

- 2.24. One respondent explained that since the analysis was undertaken by Frontier Economics, BP took the decision in early October 2004 to refocus its marketing strategy. This respondent suggested that as a result BP's market share in the downstream UK industrial and commercial customer market will fall below the 15 per cent market share quoted by Frontier Economics, however, the precise impact on BP's share of the downstream market is not yet known due to uncertainties regarding the exact timing, extent and nature of this recent change in marketing strategy.
- 2.25. In respect of future capacity utilisation, one respondent noted that Ofgem are not intending to approve any measures at this stage. However, this respondent sought clarification as to how Ofgem will judge whether the rules operated by an LNG import facility operator are deemed to meet the requirements and how in particular Ofgem would decide that primary capacity was not being used. This respondent suggested that GLNG be required to provide explicit details of the proposed bulletin board service and trading rules so that all parties understand how this would work. Another respondent considered that it was unclear as to how GLNG will create a secondary market for any unused capacity such that all capacity is made available to the market.
- 2.26. One respondent suggested that incidents of unutilised capacity do not automatically mean that capacity is being "hoarded" as there may be many compelling operational and commercial reasons causing the capacity to remain unutilised. This respondent suggested that a lack of liquidity in the

traded LNG market and logistical considerations (e.g., shipping lead times) may render it difficult for other parties to utilise capacity not required by the capacity holders.

- 2.27. One respondent noted that Ofgem has not approved the Transco Services Agreement and requested clarification on whether Ofgem would need to approve the Transco Services Agreement, or whether it merely has to approve how Transco is entitled to recover costs under the System Operator Incentive Scheme associated with Transco's GT Licence.
- 2.28. One respondent noted that Frontier Economics postulate a number of extreme theoretical scenarios, one of which assumes that BP/Sonatrach does not exercise its option over expansion rights and that Centrica (as the largest downstream player) takes all the expansion capacity. This respondent requested that Ofgem point out in its final conclusions and any formal submission to the Commission that this and the other scenarios are indeed hypothetical and that this does not reflect the position of Centrica or the other companies implicated.

Ofgem's final view

- 2.29. As mentioned previously, it should be noted that Ofgem has not specifically approved the anti hoarding measures that will be put in place by GLNG. However, should the arrangements put in place by GLNG result in primary capacity not being utilised, this could constitute grounds for reviewing the exemption, in particular on the grounds that the exemption from section 19D is operating in such a manner that is detrimental to competition or the operation of an economically efficient gas market. In Ofgem's view, at the very least GLNG will need to demonstrate that there is a transparent mechanism that allows spare capacity to be made available to market. The ultimate objective is to ensure that capacity is not hoarded and that unused capacity can be obtained in a transparent market-based manner by third parties so as to maximise the use of the LNG import terminal concerned.

- 2.30. Ofgem agrees with one respondent that incidents of unutilised capacity do not automatically mean that capacity is being “hoarded”. However, in the event that Ofgem receives complaints that GLNG’s secondary trading and anti-hoarding mechanisms are not effective, this could constitute grounds for reviewing the exemption and Ofgem would seek further information from the relevant parties involved before coming to any conclusions on possible remedies, or in extremis, revocation, or, with the consent of the facility owner, amendment, of the exemption.
- 2.31. Ofgem notes that GLNG is currently in the process of undergoing an open season for the second phase capacity and the results of this open season process are not finalised. It should be noted that when the results of the open season are finalised the drafting of the exemption order enables Ofgem to review and in extremis revoke, or, with the consent of the facility owner, amend the exemption for the expansion capacity if in the Authority’s reasonable opinion there is a material change in the degree to which the requirements of this exemption criterion is met.
- 2.32. For clarification, Ofgem does not have a role in approving the actual Transco Services Agreement contract. However, Ofgem does have a role in monitoring whether Transco has, in entering into this contract, complied with its statutory and licence obligations. In addition, any modification proposed to Transco’s network code or its GT Licence in relation to how Transco recovers these costs would come to the Authority for decision.
- 2.33. For the avoidance of doubt, the scenarios used by Frontier Economics are indeed hypothetical and to Ofgem’s knowledge do not reflect the position of Centrica or the other companies referred to in the analysis presented by Frontier Economics.
- 2.34. Ofgem considers that the Isle of Grain project should provide material benefits to upstream markets. Ofgem considers that the project should have no material adverse effect on downstream competition. This is because BP’s present market share of the retail markets in gas supply to UK industrial/commercial and power station customers is not at a level that is

likely to be detrimental to competition. Also, BP currently has no interests in the supply of gas to UK domestic customers. In the event that Sonatrach enters the retail market there is the potential for the project to benefit downstream competition. In particular, as the project would enhance the overall level of gas supply, this should increase competition to the benefit of customers, a benefit that would otherwise not have existed. Ofgem considers that this project could be expected to have an overall positive impact on competition. Ofgem considers that this requirement has been met.

(f) the Commission of the European Communities is or will be content with the exemption

- 2.35. Ofgem expected that as all of the five criteria described above seem likely to be met the European Commission should be content with the exemption.

Respondents' views

- 2.36. No respondents commented on this condition.

Ofgem's final view

- 2.37. Ofgem considers that the Isle of Grain project should provide material benefits to upstream markets and that the project should have no material adverse effect on downstream competition. Ofgem considers that this project could be expected to have an overall positive impact on competition. Ofgem therefore expects that the European Commission should be content with the exemption.

The draft exemption order

- 2.38. In Ofgem's initial views paper a draft exemption order for the Isle of Grain was included and Ofgem invited views from respondents on the draft exemption order.

Respondents' views

- 2.39. One respondent suggested that the requirement to make information public is too widely drafted. One respondent considered that the publication of certain commercial data could commercially prejudice the efficient functioning of the facility. Two respondents considered that GLNG should be subject to the same obligations for making information public as other terminal operators and as such be part of the DTI's Information Release programme.
- 2.40. One respondent considered that the power for Ofgem to request information goes beyond what is permitted in the Gas Act 1986 and suggested that Ofgem should only have access to information it reasonably requires to perform its statutory functions or to monitor compliance with the conditions of the exemption.
- 2.41. One respondent suggested the revocation of an exemption order as a result of a detrimental impact on competition caused by the direct behaviour of a throughputter may be appropriate for facilities developed by a vertically integrated organisation, which is able to exercise influence over the behaviour of the throughputter concerned. However, this respondent suggested that it is not appropriate for facilities developed by independent third parties that are unable to directly influence throughputters behaviour.
- 2.42. One respondent suggested that in many instances, remedies other than the revocation of the exemption may be appropriate and suggested that the revocation provision should make it clear that notice of the revocation can only be given after the Authority has provided all interested parties an opportunity to offer evidence and to raise issues with regard to the impact of removal of the exemption, including whether another remedy is more appropriate. Another respondent suggested that revocation should not necessarily occur in the event of bankruptcy as retention of the exemption during bankruptcy may be essential to retain the value of the asset for creditors of the facility owner and users of the facility.

2.43. One respondent noted the difference between the draft exemption for GLNG contained in the Ofgem initial views document on their formal application for exemption and the draft exemption for the South Hook LNG Terminal Company Ltd (SHTCL). This respondent considered the draft exemption order for SHTCL would also be more appropriate for GLNG Ltd as it removes the potential for ambiguity for Ofgem whilst providing a more practical framework within which Ofgem may exercise judgement.

Ofgem's view

2.44. Having considered respondents' views relating to information provision to the market, Ofgem considers that there should, where possible, be equivalence in the information required of LNG facility operators to that generally required of similar activities in relevant gas and electricity markets.

Therefore, Ofgem has removed the condition from the draft exemption order which requires LNG import facility operators to make information publicly available. However, it should be noted that, in certain circumstances, Ofgem has statutory powers to publish or disclose information.

2.45. Ofgem notes one respondent's view that the power for Ofgem to request information goes beyond what it is permitted in the Gas Act 1986. The requirement in the exemption order is similar to conditions in gas transporter licences. For the avoidance of doubt, information in this condition is information that the Authority may reasonably require or as may be necessary for the purpose of both performing the functions assigned to it and monitoring the operation of the exemption.

2.46. In respect of respondent's views on revocation, Ofgem considers that it is clear in the draft exemption order that, in the case that a material breach of the exemption criteria or a proven breach of competition law is established, revocation of an exemption would not follow automatically from such an event.

2.47. For the avoidance of doubt, in the event that any of the circumstances occur which may give rise to revocation of an exemption, Ofgem would not

automatically commence the process to revoke the exemption by giving four month notice that the exemption order is to be revoked. First, Ofgem would likely enter into discussions with the party or parties involved to establish whether genuine grounds exist for the revocation of the exemption. Second, in the absence of a need to act urgently, should Ofgem determine that there are grounds for revocation, Ofgem would likely give the party or parties involved a reasonable opportunity to remedy the event or circumstances that have caused the grounds for revocation to arise. In the event that the party or parties involved have not remedied the event or circumstances which have caused the grounds for revocation to arise, Ofgem would consider whether formal action to revoke the exemption was required.

- 2.48. Ofgem notes one respondent's view that it would not be appropriate for an exemption order to be revoked as a result of a detrimental impact on competition caused by the direct behaviour of a throughputter for facilities developed by independent third parties that are unable to directly influence throughputter behaviour. One of the criteria in considering an application by LNG import facility owners for exemption from RTPA is that the impact of the exemption will not be detrimental to competition. Ofgem considers that behaviour by throughputters at the LNG import facility is a significant factor in terms of whether the LNG import facility meets these criteria. Therefore, Ofgem considers that it is appropriate that the exemption order may be revoked as a result of a detrimental impact on competition caused by the behaviour of a throughputter. The facility owner should be able to put in place contractual safeguards to minimise the risk that the operation of the exemption becomes prejudiced by the behaviour of throughputters of the facility.

Withdrawal/amendment of an exemption by the European Commission

- 2.49. As set out previously, Ofgem has recently clarified the process by which an exemption decision should be notified to the European Commission. To reflect this clarification, Ofgem has made amendments to the exemption order set out in Appendix 1 to this document as compared with the draft exemption orders that were initially consulted on as part of the formal

application for exemption in respect of the South Hook LNG import facility¹⁰ and the Isle of Grain LNG import facility.¹¹

- 2.50. To ensure consistency, Ofgem intends to reflect these amendments in any exemption orders that may be granted under section 19C, including the exemption order for the Isle of Grain LNG import facility.
- 2.51. It should be noted that a condition of the exemption is that the material provided by the facility owner to the Authority in respect of the exemption is accurate in all material respects. Therefore if the start date for the commercial operation of the first or second phase of the facility was significantly later than the start date suggested in the application this could constitute grounds for reviewing the exemption. Further, Ofgem would expect the facility owner to promptly inform it of any material change to its plans regarding the relevant start dates for the facility or indeed any other statement of intention (for instance, the commitment to put in place UIOLI arrangements).

Transfer of an exemption

- 2.52. Ofgem has made a further amendment to the exemption order set out in Appendix 1 to this document as compared with the draft exemption orders that were consulted on previously. This is to allow for the transfer of an exemption to another facility owner and is dependent upon the written consent of the Authority. Again, Ofgem intends to reflect this amendment in any exemption orders that may be granted under section 19C.

Conclusions

- 2.53. Ofgem remains of the view that it would be appropriate to grant an exemption for the entire proposed capacity of the Isle of Grain LNG import

¹⁰ 'Consultation on an application by South Hook LNG Terminal Company Ltd (SHTCL) (owned by Qatar Petroleum and ExxonMobil) under section 19C of the Gas Act 1986 for an exemption from section 19D of the Gas Act 1986', Ofgem, October 2004.

¹¹ Application by Grain LNG Ltd under section 19C of the Gas Act 1986 for an exemption from section 19D of the Gas Act 1986, Ofgem, October 2004.

facility on Isle of Grain (i.e. the initial capacity of 4.5 billion cubic meters per year for a duration of 20 years and the expansion capacity of 10 billion cubic meters per year for a duration of 25 years from when commercial operations commence) to GLNG under section 19C(5) of the Gas Act 1986 from the application of section 19D of the Gas Act 1986.

- 2.54. For the avoidance of doubt, Ofgem's analysis has been carried out against the exemption criteria and is specific to the application for an exemption that Ofgem is considering. Any decision that Ofgem may make in relation to this application for an exemption does not preclude or impact in anyway on the operation of the Competition Act 1998 or the Enterprise Act 2002. Further, as the analysis contained in this document is in relation to a specific situation, the analysis may or may not necessarily be relevant to a consideration of any related issues that may arise, for example under the Gas Act 1986, the Competition Act 1998 or the Enterprise Act 2002.

3. Way forward

- 3.1. This final views document, together with the exemption order and all supporting documents will be submitted to the European Commission.
- 3.2. As mentioned previously, the European Commission has two months in which it can veto a decision by the relevant authority in a Member State to grant an exemption, or request that the regulatory authority amend its decision.¹²

¹² This two month period may be extended by one additional month where additional information is sought by the Commission.

Appendix 1 Exemption order

GAS ACT 1986 SECTION 19C

EXEMPTION

Pursuant to sub-section 19C(5) of the Gas Act 1986 (the Act), the Gas and Electricity Markets Authority hereby gives to Grain LNG Ltd¹³, as the owner of an LNG import facility, an exemption from the application of section 19D of the Act in respect to the LNG import facility located at the Isle of Grain, Nr Rochester, Kent, ME3 0AB subject to the attached Schedule.



Steve Smith

Authorised in that behalf by the

Gas and Electricity Markets Authority

Dated 3 December 2004

¹³ Registered in England No. 4463679. Registered Office: 1-3 Strand, London, WC2N 5EHX.

SCHEDULE
PERIOD, CONDITIONS, AND REVOCATION OF EXEMPTION

A. Interpretation and Definitions

In this exemption:

“the Authority”	means the Gas and Electricity Markets Authority established by section 1(1) of the Utilities Act 2000
“the Act”	means the Gas Act 1986 as amended from time to time
“the facility”	means LNG import facility
“facility owner”	means Grain LNG Ltd in its capacity as owner of the facility
“facility operator”	means Grain LNG Ltd in its capacity as operator of the facility
“throughputter”	means any user of the facility

B. Full description of the LNG import facility to which this exemption relates

The Grain LNG import facility with:

- (a) an initial capacity of 4.5 billion cubic meters per year and;
- (b) an expanded capacity of 10 billion cubic meters per year.

C. Period

Subject to Section E below, and pursuant to section 19C(3)(a) of the Act, this exemption will cease to have effect:

- (a) in respect of the initial capacity of the facility, 20 years from the date that the facility commences commercial operation; and
- (b) in respect of the expansion capacity, 25 years from the date that the expansion capacity commences commercial operation.

D. Conditions

Pursuant to sub-section 19C(3)(b) of the Act, this exemption is made subject to the following conditions:

1. That the material provided by the facility owner to the Authority in respect of this exemption is and remains accurate in all material respects.
2. The facility owner notifies the Authority within ten days of:
 - (a) the initial capacity of the facility commencing commercial operation; and
 - (b) the expansion capacity commencing commercial operation.
3. The facility owner furnishes the Authority in such manner and at such times as the Authority may reasonably require, with such information as the Authority may reasonably require, or as may be necessary, for the purpose of:
 - (a) performing the functions assigned to it by or under the Act, the Utilities Act 2000, or the Energy Act 2004; or
 - (b) monitoring the operation of the exemption.
4. The facility owner complies with any direction given by the Authority (after the Authority has consulted the relevant gas transporter and, where relevant, the Health and Safety Executive) to supply to the relevant gas transporter such information as may be specified or described in the direction -
 - (a) at such times, in such form and such manner; and
 - (b) in respect of such periods, as may be so specified or described.

Where the facility owner is prevented from complying with such a direction by a matter beyond its control, it shall not be treated as having contravened the condition specified in this paragraph.

In this condition:

"information"	means information relating to the operation of the pipeline system which is operated by a relevant gas transporter
"relevant gas transporter"	means any holder of a gas transporter licence under section 7 of the Act owning a transportation system within Great Britain to which the facility is connected or with whom the facility operator interfaces with as a system operator

5. Should any of the grounds for revocation arise under section E of this exemption, the Authority may, with the consent of the facility owner, amend this exemption rather than revoke the exemption.
6. The Authority may, with the consent of the facility owner, amend this exemption where the Authority has been requested to amend the decision to grant this exemption by the European Commission (such request being made in accordance with Article 22(4) of Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003).
7. This exemption is transferable to another facility owner where the Authority has given its written consent to such a transfer. For the avoidance of doubt, all of the conditions contained in this exemption order continue unaffected in respect of any facility owner to whom this exemption order may be transferred.

E. Revocation

Pursuant to sub-section 19C(4) of the Act, this exemption may be revoked in the following circumstances:

1. The Authority may revoke this exemption where the European Commission has requested (in accordance with Article 22(4) of Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003) that the Authority withdraw the decision to grant this exemption.
2. The Authority may revoke this exemption where the European Commission has requested (in accordance with Article 22(4) of Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003) the Authority amend the decision to grant this exemption and the facility owner does not agree (under paragraph D6 above) for this exemption to be amended in the manner so requested by the European Commission.
3. This exemption may also be revoked by the Authority by giving a notice of revocation to the facility owner not less than four months before the coming into force of the revocation in any of the following circumstances:
 - (a) where:
 - i. in the Authority's reasonable opinion there is a material change in the degree to which the requirements of sub-sections 19C(7)(a), (c), (d) or (e) of the Act are met with respect to the facility as the result of any action or omission of the facility owner, facility operator, or throughputter;
 - ii. the facility owner has a receiver (which expression shall include an administrative receiver within the meaning of section 251 of the Insolvency Act 1986) of the whole or any material part of its assets or undertaking appointed;
 - iii. the facility owner has an administration order under section 8 of the Insolvency Act 1986 made in relation to it;

- iv. the facility owner is found to be in breach of the Competition Act 1998; or
 - v. there is merger or acquisition activity in relation to, or by the facility owner, that is detrimental to competition.
- (b) the facility owner has failed to comply with a request for information issued by the Authority under paragraph D3 above and the Authority has written to the facility owner stating that the request has not been complied with and giving the facility owner notice that if the request for information remains outstanding past the period specified in the notice, the exemption may be revoked; or
- (c) the facility owner has failed to comply with a direction issued by the Authority under paragraph D4 above and the Authority has written to the facility owner stating that the direction has not been complied with and giving the facility owner notice that if the direction remains outstanding past the period specified in the notice, the exemption may be revoked.