

Eni Gas &Power's response to ERGEG's Consultation Paper on "Draft Guidelines of Good Practice on Third Party Access for LNG System Operators (GGPLNG)"

Introduction

Eni Gas &Power in principle is in favor of the harmonization path of access rules to European gas system and welcomes the aim of the consultation process in matter of defining Good Practice on Third Party Access for LNG System Operators. Even if LNG System has specific features that have to be considered in developing access rules, a common set of referring principles would doubtfully lead to greater interoperability of internal market, increasing market liquidity and contributing to the creation of an European gas market.

ERGEG General Questions

1. The GGPLNG aim is to boost effective, appropriately homogeneous and nondiscriminatory, third party access to European LNG terminals without being detrimental to new investments. How could TPA/harmonization and investment be conciliated?

An harmonization process should result in a common framework at European level where LNG System access rules, as Transmission and Storage ones converge at least towards the same stable and uniform guiding principle. Regulatory stability is an important condition to be realized to incentive long term and substantial investments where financing operators need to perceive long term profitability.

Harmonization should result also in a better comprehension of international gas market functioning, another condition that helps new international investments.

Anyway should be introduced and harmonized also investment incentives, that could be introduced in different ways, paying attention to avoid the introduction of mechanisms that guarantee the recovery of the investment regardless the gas volumes. Indeed, this kind of mechanism would introduce risks of investments not directly linked to the effective capacity needs and would produce system loads.

Beside that, it is our opinion that the stronger incentive for investment in new infrastructure is given by exemption from TPA service, granted in application of article 22 of Directive 2003/55/EC. For this reason application conditions of article 22 should be clearly ex ante defined but also flexible enough to constitute an effective incentive, avoiding the introduction of restrictive and limitative terms.

II. The GGPLNG aims at facilitating harmonization of services, procedures, conditions... in order to foster interoperability and facilitate access to regulated LNG facilities. To what extent is harmonization of regulated access procedures convenient/possible? Which areas should be harmonized (i.e. transparency, network code procedures, balancing rules etc.)? Is the current degree of detail and prescriptive nature of the GGPLNG considered adequate? Is the need for common EU-wide requirements adequately balanced against the need for flexible rules?

LNG System presents significant differences between regional European markets that make more difficult to achieve a uniform level of harmonization among Europe's LNG markets. The effort of harmonizing is helpful for the reason expressed above but it should be avoided too prescriptive requirements to preserve necessary flexibility in respect of different market features and developed operational, safety and commercial practices. To obtain a correct balance between the principle of harmonization and the need of flexible LNG rules, regulators should focus on the key few areas that can add value through harmonization that means to create convergence in allocation firm capacity process (including the timing and the nature of notification) and in transparency requirements.

III. Considering the voluntary character of the GGPLNG it would be interesting to know what transitional effects you think the GGPLNG implementation could cause, and what could the implementation cost be in your particular case. Are you going to get benefits (commercial, decrease of management cost etc.) with the GGPLNG application?

The LNG industry has developed numerous operational, safety and commercial practices throughout the many years of operation and experience. As long as GGPLNG is voluntary Member States should not experience detrimental impact or hard implementation costs. Once TPA applied to LNG system should become compelling as content of the new Regulation 1775/2005, changes would be implemented and would follow costs and benefits that it's difficult to evaluate. Anyway it's important to avoid compelling retrospective changes to existing arrangements, in particular referring to commercial arrangements that LNG suppliers/buyers and LNG regasification developers enter into to balance the relevant risk of investments.

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.)?

GGPLNG could be the reference for access conditions to be defined for non exempted part of a terminal exempted under Article 22 of Directive 2003/55/EC. Moreover some provisions as about congestion management or transparency could be useful and may be a reference also to manage exempted capacity. Anyway it must also be clear that LNG facilities that have already received Article 22 exemptions are not covered by the GGPLNG.

V. The GGPLNG establish that tariff structure should be reviewed on a regular basis. Would the GGPLNG fix a minimum and/or maximum frequency for such a review? Which frequency(ies) should be the appropriate?

In principle the frequency of tariff review should be the lowest to guarantee stability for investors and system users, but at the same time should be suitable to guarantee the correct recovery of costs and the return on investments.

Some circumstances could bring about the need of tariff review, as for example the under or over utilization of the asset or regulatory changes. In our opinion It's not relevant that GGPLNG specify a minimum and/or a maximum frequency for tariffs review; instead it's important that review frequency is established by National Regulatory Authority, known to infrastructure users and that review processes are robust and transparent and that all interested parties can participate in the procedure. Tariff reviews conducted in the absence of robust procedural protections for investors and system users, could add costs to development due to increased regulatory risk.

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.¹ 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 trade of unbundled components of the TPA services is limited by the fact that the components are inextricably linked .Moreover experience thus far in the global LNG industry (including experience in Europe) indicates that secondary capacity trading and use of interruptible capacity has not yet emerged. However, there is the possibility of offering additional services to the primary capacity holders on a reasonable endeavors basis (i.e., increased daily send-out). Such services need to be defined and made transparent to LNG system users.

. Anyway tariffs for firm and interruptible capacity, bundled or unbundled services should be cost reflective and avoid cross subsidization.

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

We agree with this approach; a more prescriptive one wouldn't be consistent with technical feature of each LNG facility

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?

Service design should be dictated by the requirements of the market and the impact on the efficient financing and development of LNG assets. Short term capacity should be made available only at the end of long term and annual capacity contracting procedure and related tariffs should be calculated on the basis of the contractual length. Tariffs must give correct market signals reflecting system transmission costs; for this reason short term capacity tariffs should be higher than tariffs for long term transportation services and should be calculated so that all users could equally contribute to cover infrastructure fixed costs through tariffs. From this point of view, a seasonal variation of tariffs during the year, where winter tariffs are higher than summer ones, is also recommended.

IX. Requests have been made during the July pre-consultation with stakeholders for specific standardized regasification contracts (e.g. front month contract) that aim to facilitate the trading of the regasified LNG on natural gas markets. What type of standardized services could be offered by the LSOs? To what extent would these services be compatible with technical constraints (e.g. available storage capacity), the efficient operation of each terminal and innovation in the offering of terminal services? How prescriptive should the GGPLNG be about standardized contracts?

Standardized services and standardized voluntary contracts are useful instruments that should be added, where consistent with technical constraints, to each specific LNG facility existing contracts and services. Standardized instruments should be kept as voluntary ones and GGPLNG shouldn't be prescriptive about standardized contracts that should be a reference instruments and should respect different market circumstances and technical facilities features.

X. Considering that harmonized network codes should take into account specificities of each terminal, which issues could be common and under which conditions?

See the answer to question II.

XI. Electronic communication tools seem to be the most suitable means for the LSOs to exchange information with the terminal users. What type of platform could be needed? What services should be available on it (e.g. secondary market, nominations, etc.)? Should a simplified system based, for example, on fax transmission, be envisaged in certain cases and, if so, when?

Electronic communication tools are surely the most efficient way for the LNG system users to exchange information with the LSO, in particular a web-based platform is the best way to nominate.

XII. Even though several platforms already exist and software could be copied to a certain extent, the development of electronic communication tools represents a certain cost. Do you think the cost/benefit ratio would be acceptable?

It's difficult to evaluate cost/benefit ratio of the development of electronic communication tools. In our opinion this kind of instruments would be extremely helpful, but surely it would be conducted the necessary analysis to evaluate the acceptability in terms of tariffs increase of such a cost.

XIII. The GGPLNG consider the cooperation between LSOs when putting in place compatible scheduling procedures in order to facilitate capacity trading and interoperability between European terminals. Do you think that such a harmonization of scheduling procedures is desirable? Would it be necessary and proportionate to introduce some minimum harmonization of these procedures within the GGPLNG to facilitate capacity trading and interoperability between European terminals? What requirements can be envisaged?

Regulated LSOs should strive to standardize scheduling procedures, including the establishment of a uniform start date for the prompt month as well as a uniform lead time for scheduling. Moreover, it would be helpful if the industry could utilize a standard unit of measure. These rules should be made transparent. However, NRAs need to recognize that the long experience in global LNG trade has already resulted in standardized scheduling procedures. Moreover, each market may do its own variation to accommodate unique circumstances. Furthermore, procedures in place for existing facilities may be difficult to change without causing disruption.

NRAs should examine the scheduling procedures of regulated LNG facilities to determine whether they are reasonable, non-discriminatory and fit for purpose.

NRAs should also be mindful that the scheduling procedures should not restrict the use of the capacity by the primary firm shippers, including the flexibility embedded in the service.

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 optimize the utilization of the terminal capacity?

– Should the GGPLNG be more or less prescriptive regarding procedures to manage congestion in the terminals?

The principles of non discriminatory allocation rules for primary and secondary capacity and the proposed market based solutions are sharable and do not require the inclusion in GGPLNG of specific subscription procedure.

The presence of a secondary capacity trading mechanism should not cause any distortion to the fact that optimal capacity utilization has to continue to be driven by global price signals. The presence of secondary market mechanisms shouldn't be prescriptive and shouldn't change the incentives to flow cargoes to higher priced markets in other parts of the world and users shouldn't be penalized for reacting to these market signals.

XV. Reference is made to capacity that the holder is no longer able to use. An obvious example is the case of (unbundled) regasification capacity owned by a shipper who has no more gas in storage. What are the other cases where capacity could be categorized as no longer usable? Who must decide when a capacity holder is considered as no longer able to use the capacity?

The fact that a user has no more gas in storage (with the exception of minimum stock levels) does not necessarily indicate that the facility is unused as the shipper may be in the process of delivering a cargo to meet minimum stock levels. Generally, a facility is not being used if LNG is not being delivered to a facility when global market conditions suggest that LNG should be. However, circumstances are unique and should only be scrutinized by an NRA after the event, subject to placing the burden of proof upon the NRA. There is a risk of creating presumptions of when a facility is "not being used" as such presumptions may impair the commercial arrangements made by primary

capacity holders. So long as primary capacity holders have entered into long term ship or pay capacity arrangements that cover the fixed costs of the asset, the presumption should be that the facility is being “used”.

Moreover it should be avoided to consider capacity no longer usable, and consequently to proceed, as stated in GGPLNG article 5.3, to reallocate it to the market as firm capacity, when the primary holder can't temporarily use it for reasons of Force Major even if occurred out of the specific LNG facility.

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 maximize 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 LNG services should be allocated with a priority upon non bundled services; the trade of unbundled components should be allowed as residual but it remains the difficulty in selling parts of the bundled LNG regasification services. For example, the use of operational storage and send out is limited by the need to physically unload a subsequent cargo to replace stock levels. Accordingly, a party seeking to purchase only send out capacity will also need to compensate the primary capacity holder for replacing the gas in store with a new cargo and such compensation would include price risk and lost option value.

XVII. The GGPLNG tries to assure the optimum utilization 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?

Primary capacity holder's rights should be protected and the conditions when capacity reallocations are appropriate or when a capacity hoarding is supposed to be in place should be deeply evaluated in this view, also considering that primary capacity holders have made financial commitments that have allowed the facilities to be built in the first instance.

It's important to agree between all parties, including NRA, the clear definition of what has to be considered “capacity hoarding”; this concept should be applicable just to rigasification arrangements finalized after such definition,

XVIII. The GGPLNG distinguish between punctually unused capacity and systematically underutilized 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?

The definition of “unused capacity” and “capacity” set forth in Regulation 1775/2005 are not sufficiently precise to reflect the operation of LNG facilities as the definitions have been designed for pipeline systems that use day ahead (and shorter) timeframes for nominations and re-nominations. The nomination procedure for LNG facilities usually requires a month-ahead confirmation of the berthing slot. Also, LNG nomination procedures typically do not require that tank storage capacity be nominated separately because use of the storage component is embedded, and thus implicit, in the service. In other words, a reduction of send out implies that the storage component will be used. Accordingly, the current Regulation implies that failure to nominate a berthing slot means that the facility is not being “used” when, in fact, other components of the LNG service are being used. Accordingly, the definition of “capacity” and “unused capacity” need to be made more precise to accommodate the unique circumstances of LNG facilities.

– Is there a need to distinguish between punctually unused capacity and systematically underutilized capacity as states the current draft of the GGPLNG? Is the proposed split between reallocation of unused capacity and release of underutilized capacity a good approach?

We agree with the distinction between punctually unused capacity and systematically underutilized capacity. About the GGPLNG definition of underutilized capacity, the first circumstance that has to occur (“systematic underutilization of the allocated capacity”) should be limited to cases where systematic underutilization is not due to Force Major reason that prevent capacity usage, occurred to the primary users also out of the LNG facility.

In any case these kind of mechanism mustn’t apply in case of facilities build under art. 22 exemptions and in different cases robust procedural protections must be designed to protect the interests of investors; in case of capacity reallocation, it should be conducted on interruptible basis and the primary capacity holder must be compensated for all losses associated with the taking of its property right – not just relief from paying capacity charges.

– Is it satisfactory to empower the NRA to evaluate if there has been systematic underutilization of capacity or should the concept of ‘systematic underutilization’ be described more accurately in the GGPLNG, by specifying the criteria to be used?

The concept of “Systematic underutilization” should be the more as possible specified and should be defined according to the principle expressed above.

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?

Given the difficulty of addressing the unique circumstances present in various European markets, the GGPLNG should set general principles for LNG congestion management.

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?

Proposed section 38 (a) attempts to strike a reasonable balance between the right of a primary shipper to retain flexibility and the interests of a potential secondary shipper. Specifically, the notice period “must be long enough to allow for another shipper to organize a shipment and short enough to allow capacity holder to determine which capacity it is not using”. However, the flaw with this approach is that it deprives the primary shipper of its contractual rights to use capacity and grants that right to a secondary shipper. Specifically, at a specific point in time, the primary capacity holder is no longer entitled to “organize a shipment” but a secondary shipper is so entitled. Given that the primary capacity holder has financially backed the development of the asset in the first instance, it seems that the proposed mechanism results in unequal treatment

Given the different market circumstances, including shipping times, individual Member State NRAs must establish the appropriate balance. In addition, the individual NRAs can consider the impact of the deadline (and corresponding reduction in flexibility) on the value of the commercial service and the impact on supply security.

XXI. The GGPLNG establish the principles to release underutilized 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 underutilized capacity should be released? Would a less constraint mechanism be preferable?

Given the difficulty of addressing the unique circumstances present in various European markets, the GGPLNG should set general principles for LNG congestion management. The concept of “Systematic underutilization” should be the more as possible specified; also the concept of “reasonable price” should be

clarified In any case systematic underutilization of the allocated capacity should be limited to cases where systematic underutilization is not due to Force Major reason that prevent capacity usage, occurred to the primary users also out of the LNG facility. These kind of mechanism mustn't apply in case of facilities build under art. 22 exemptions.

XXII. The GGPLNG try to summarize the most important operational and commercial information to be published by the LSOs. What other types of information should the LSOs provide to the market to improve the transparency and the efficiency of the market?

XXIII. In your view, are there other points regarding transparency that should be addressed in the GGPLNG?

Eni Gas & Power considers the transparency requirements proposed sufficient. Moreover an effective transparency should be realized also through the resolution of linguistic barriers. Nowadays often documents are not available in English or are available just after the conclusion of the procedure to which documents are related. Moreover, in order to facilitate the availability of information it would be useful that, in case of deadlines or new relevant information, LSOs websites sent alert to all users and to operators who registered themselves in the websites. An improvements that in our opinion is necessary to allow a better information usability is the adoption of excel or cvs formats to publish numerical data; pdf formats don't allow to easily handle and elaborate information.

XXIV. Opinions have been expressed that in some markets, organized trading of capacity rights might not be necessary, or that the benefits this trading provide to LNG terminal users could be reached by other means. Is an organized secondary capacity market in the terminal useless, useful or necessary? Should the GGPLNG recommend the creation of a secondary market for capacity or should this be left to each LSO or NRA's appraisal?

The competitive global LNG industry is accustomed to using DES transactions as the means to access secondary capacity. In addition, the excessive cost and complexity of establishing an explicit secondary capacity market could outweigh any benefits. Moreover, there is a significant risk that the zeal to create secondary markets will impair the efficient use of capacity by primary users. Accordingly, an organized secondary capacity market for LNG could be of little use.

XXV. Considering a need for a secondary capacity market in the terminal, what features would be needed for an efficient functioning of this market? Comments on this issue would be welcome, i.e.:

– How crucial is contracts' standardization for the development of secondary market?

Standardization of the secondary market has already taken place in the global LNG industry and will continue to evolve, driven by competition. LSOs should not hinder development of secondary capacity trading and could facilitate such trading by cooperating with ship vetting and gas quality assurance. However, secondary use of capacity requires the cooperation of the primary shipper due to its need to manage stock and the shipping schedule. So long as the primary shipper is fairly compensated for market value and other risk, then secondary capacity trading will emerge and supplement use of DES transactions.

– Should contracted capacity that has not been nominated be offered on the secondary market by the LSO if the capacity owner does not do it?

Capacity that has not been nominated could be offered on the secondary market by the LSO on short term and interruptible basis; primary capacity holder's rights should be protected as long as primary capacity holders have also made financial commitments that have allowed the facilities to be built in the first instance.

Furthermore, if the primary shipper is required to surrender unused capacity to the LSO for subsequent marketing, the primary shipper should be relieved of any obligation to pay for such capacity, regardless of whether it is subsequently sold.

– What is your interest in the offer/demand of not bundled capacities on the secondary market (e.g., berthing capacity, storage capacity etc.)? Have you encountered obstacles regarding this that would justify developing more specific rules about the trading of not bundled LNG services in the GGPLNG?

The creation of such services would certainly not hinder global trade or OTC development of LNG capacity products, if the trade of unbundled components should be allowed as residual but it remains the difficulty in selling parts of the bundled LNG regasification services. Eni doubts the level of interest of offering unbundled access/capacity services at LNG facilities .

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