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Sent: Friday 11 September 2015 15:31
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Subject: LNG and gas storage strategy: report of meeting with GIE yesterday

Summary:

- Interesting and informative meeting yesterday with GIE (represented by LNG terminal operators from France, Spain, the Netherlands and Poland). Commission represented by copy recipients.

- Clear tensions between GIE members on some issues. But general consensus that the market for LNG import terminal capacity was working well – lots of competition between existing terminals and no obvious barriers to address.

- Plea for a level playing field (e.g. on regulation/exemptions and on 'subsidies' for any new terminals).

Detail (if interested):

General

- EU should define the role of gas in Europe as there are mixed messages coming from COM [comment: this was essentially a reference to the demand graph in the annex to the consultation – we made the same points in response as you did Christopher in the meeting with Eurogas].

- First have a strategy for gas, then, deriving from it, a strategy for LNG. LNG competes with storage, with pipelines and with other fuels.

International markets / technology etc

- The next 5 years are fairly certain in terms of supply (we know there will be a 50% increase in liquefaction capacity and – once built – it will be used). Post 2020 there are more uncertainties as liquefaction terminals that are planned or proposed may not be built

- On the demand side (and hence on prices) nobody really knows what will happen – it will depend on many factors, including China's economy. But most people seem to think they will be low for the next few years because of supply side boom.

- No 'destination clauses' as such for deliveries to the EU (which would be illegal). But some contracts are DES (delivery ex-ship at a particular place) rather than FOB (free on board). That's normal commercial practice for commodity trading and not an area where Commission needs to

interfere. DES contracts can be renegotiated by the parties to redirect a cargo and in any case there were likely to be more FOB contracts in future (e.g. from new supply sources such as US) and a general increase in flexibility as the size of the market (and the number of cargoes on the water at any one time) grew.

- Regasification in the EU typically cost $0.4-0.8/mmbtu. Transport from the US to the EU might cost $1/mmbtu. And liquefaction at a new US plant would be $2.5-3.0. So at Henry Hub prices US plants may be able to make a profit with EU prices at $7/mmbtu. And would supply at even lower EU prices e.g. $6 because most of their costs related to the borrowed capital and were thus fixed (and so would be the same whether they ran or not).

- Fukushima and the drought in Latin America showed that the LNG market was flexible and could adjust to price signals. And it would become more so as it grew in size.

- On the transport side, LNG use in off-grid industry was growing slowly, and in shipping. LNG uptake in lorries was proving more problematic. But in all these cases supply chain would adapt to demand – what was needed was for companies involved in road freight, shipping etc to choose LNG vehicles/vessels. But it would remain small scale compared to heat or power (e.g. even 1,000 ships running on LNG by 2020 (an unrealistically high number) would only require 2mt of LNG).

<u>EU internal market</u>

- There is a well-functioning market for LNG (in the West) due to high level of interconnectivity and sufficient liquidity. Broadly speaking, every LNG terminal in the EU is seen as a competitor by every other.

- Suppliers can buy options on LNG supply if they wish. I.e. if you want protection (guaranteed supply) at times of crisis then you can buy that in the market. Or you accept the high prices that may obtain if there is a crisis.

- In the East, the LNG terminals at Klaipeda and in Poland are seen more as market makers for their respective regions, partly because of the lack of interconnection.

- This is a long term business. Terminal operators look 40 years ahead or more when making decisions on infrastructure.

- As to regasification terminals in Europe, although these are often said to be operating at well below capacity, this is in some ways misleading: capacity may be reserved (i.e. paid for) but not used, and while actual throughput may be, say, 5% of maximum regasification rate, storage tanks may routinely fluctuate between 0 and 100% full (on average, around 50% of the EU's LNG storage capacity would be full at any one time, i.e. 4mcm from a total 8mcm)

- Indeed the prospect of increased global supply meant many EU terminals were looking at expansions: additional capacity would allow them to book more reserves and provide more flexibility to customers (this is another reason they were wary of 'subsidies' for new terminal capacity).

- There are no critical regulatory barriers at the level of LNG terminals.

- Some tensions, though: for example

  - There's a mix of regulated and exempted (from under tariff setting) terminals which may cause issues in terms of level playing field (we'll see in France as soon as Dunkerque starts operation (Dunkerque is exempted and it's in the same market zone as non-exempted terminals).

  - GATE terminal operator (NL) believes regulatory framework for LG should be the same as for storages, i.e. tariff setting for terminals should not be regulated but left to the operators to negotiate

  - Administrative barriers: if regulated terminals want to start new services (bunkering, reloading, etc) they may require approval by the NRA, which can take time. Exempted terminals are faster to react in such cases and hence have competitive advantage

- If (EU) intervention were needed, it should be on a case-by-case basis and grounded in high quality cost-benefit analysis (CBA). This CBA needed to have realistic, carefully defined assumptions [comment: most if not all those present thought the market should be left to do its job and intervention should be the exception].

- PL TSO: Regional approach is fine but needs to have common assumptions on the EU level (because the sphere of interest of many terminals will cover more than one region – see point above about competition between terminals)

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