Deliberation of the French Energy Regulatory Commission (CRE) of 7 July 2011 on approval of the Open Season Procedure for the revamping of the Fos Tonkin LNG terminal.

Attending the meeting : Olivier CHALLAN BELVAL, Frédéric GONAND et Michel THIOLLIERE, Commissioners.

The goal of the deliberation is to validate the Open Season procedure for the revamping of the Fos Tonkin LNG terminal.
CRE introduces an incentive regulation mechanism so that Elengy is incentivized financially to contain the terminal revamping costs. The mechanism includes especially:

- A bonus for Elengy if the investment made are lower than the forecasted investment published in the Information Memorandum;
- A gradual decrease of the investment remuneration by the tariff if the project final cost overruns the forecasted investment.

Fos Tonkin LNG terminal, located at Fos-sur-Mer on the Mediterranean shore and run by Elengy, can receive Medmax type LNG vessels carrying up to 75,000 cm of liquefied natural gas (LNG).

The terminal curently has a regasification capacity of 5.5 bcm/year. Its commercial running is to end in 2014. No capacity has been commercialized from October 2014.

Besides, beyond 2014, two out of three tanks could be dismantled and facilities will need to be revamped in order to grant minimum regasification capacities of 3 bmc/year. Elengy estimates at €45m$_{2011}$ the required investments.

To maintain regasification capacities at 5.5 bcm/year or to bring them up to 7 bcm/year, the LNG terminal requires greater investments (construction of a new tank, jetty revamping, etc.) that, today, Elengy estimates respectively at €255m and €325m .

To validate investments, Elengy launches an Open Season for capacity subscription up to 7 bcm/year at the Fos Tonkin LNG terminal, starting in October 2014 and for up to 20 years.

Elengy considers two revamping scenarios known as "Horizon 2035":

- a "haut" project allowing commercialization of up to 7 bcm/year of regasification capacities;
- a “bas” project allowing commercialization of up to 5.5 bcm/year of regasification capacities.

In the event of none of the two projects receives market approval, Elengy would consider a third project; known as “Horizon 2020”, allowing commercialization of 3 bcm/year until 2020.

Under the circumstances, Elengy submitted to CRE’s approval the Open Season procedure composed of the Information Memorandum (see annex A) and the allocation rules (see annex B and annex C).

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I. Open Season Project Description

1) Conduct of the Open Season Procedure

The Open Season procedure Elengy initially suggested has 3 main stages:

- qualification of subscribers enrolled in the Open Season procedure between 5th May and 9th September 2011;
- capacity allocation :
  - submission and simulation of allocation based on non-binding bids between 5th May and 26th September 2011;
  - submission and allocation based on binding bids between 26th September and 18th November 2011;
- decision of initiating the Fos Tonkin terminal revamping project based on the results of the Open Season procedure (end of 2011).

2) Allocation Rules

Once qualified for the non-binding phase, subscribers are invited to submit a subscription bid consisting of a maximum of 10 capacity profiles.

Each capacity profile is characterized by a period ranging from 4 to 80 quarters, an annual regasification capacity greater than or equal to 5 TWh / year, and a number of annual unloading operations.

The classification method of the profiles that Elengy suggested is based on three priority criteria:

- Priority 1: length of profile, priority being given to the lengthiest profile;
- Priority 2: Profiles whose ratio [annual unloaded quantity / number of annual unloading] is greater than 400 GWh;
- Priority 3: Profiles exceeding 10 TWh / year on average over the subscription period are given the same priority. Profiles from 5 TWh / year to 10 TWh / year are sorted in descending order of quantity.

The regasification capacity will be allocated to subscribers, by profile, in descending order of priority based on the classification described above.

In addition, if the total capacity requested by a subscriber is greater than 66.7% of the total capacity offered, then the subscriber profiles are directly associated with a priority lower than that of profiles submitted by other subscribers with the same length.

If at the end of this ranking, there are profiles tied after the application of priority criteria described above, a draw will be made between these profiles.

It should be noted that as part of the project “Horizon 2020”, Elengy defined specific rules in the Information Memorandum.

3) Tariff Visibility and Economic Test

Elengy suggests selecting the scenario related to the project "Horizon 2035" through an economic test. It is defined so that the average unit price estimate for the running period of the terminal does not exceed 1.1$€_{2011}$/MWh. Elengy based its average unit price calculation on projected costs published in the Information Memorandum and the current tariff framework, which includes the application subject to conditions of an investment incentive of 2% over 10 years.

The economic test will be positive if the capacity subscriptions are on average higher than, respectively, about 84% capacity of the project " Horizon 2035 haut" at 7 bcm/year, and about 93% of the capacity of the project "Horizon 2035 bas" at 5.5 bcm/year over a period of 20 years from 1 October 2014.

Assuming a full booking of the capacity of the terminal and the inclusion of an accelerated depreciation of assets from 2013, Elengy provides for the "Horizon 2020" project an estimated average price of 1.4$€_{2011}$/MWh over the period 2015-2020.

II. Synthesis of the public consultation

To prepare the present deliberation, CRE auditioned Elengy on 28th June 2011 and organised a public consultation from 5th June to 15th June 2011 covering:

- the preliminary Information Memorandum published by Elengy describing the project framework and the allocation rules;
- the complementary propositions foreseen by CRE.

CRE received 7 responses. The evaluation of comments received through the public consultation and the individual non-confidential responses are published together with the present deliberation.

Market players approve the principles adopted by Elengy in the preliminary Information Memorandum. Some of them request some minor adjustments to the timing of the Open Season. A majority asks for the practical details of the exit clause (article 11.9 of the special conditions) and of the renegotiation clause (article 11.11 of the same document) to be clarified.

In addition, though market players approve the principle behind the complementary propositions foreseen by CRE to incentivise Elengy to contain the cost of the project and to stick to its schedule, they call for these propositions to be reinforced in the sense of a better sharing of the risks associated to the project between Elengy and the subscribers.

III. CRE's Analysis

1) Open Season Schedule

Two shippers have requested an adjustment of the schedule proposed by Elengy with regards to the end date for the non-binding phase and the length of the binding phase.

Elengy is willing to amend the schedule of the Open Season to take into account these requests, while sticking to the proposed end date for the whole process so that the final decision can still be made by the end of 2011. On these grounds, Elengy suggests the following amendments:

- end date for qualification: postponed from the 9th September to 16th September 2011;
- end date for submitting the non-binding bids: postponed from 16th September to 23rd September 2011;
- date for notification of the results of the non-binding phase: postponed from September 23rd to September 30th 2011;
- start date of the binding phase: postponed from September 26th to October 3rd 2011
- end date for submitting binding bids: postponed from October 14th to October 21st 2011

CRE considers that this proposal meets the requests these two shippers expressed.

2) Incentive contribution

To avoid potential subscribers submitting non-binding bids that would be significantly different from the subsequent binding bids, Elengy asks them to commit to pay an "incentive contribution" of €50,000. This contribution will be reimbursed if the difference between the binding bid and the non-binding bid is lower than 30%.

Two market players are opposed to this contribution, which constitutes - in their view - a risk to limit participation in the Open Season.

Elengy considers this contribution is necessary for the non-binding phase to be representative of the actual needs of the market.

CRE considers that such a contribution is indeed necessary for having an efficient non-binding phase. In addition, interested market players will have sufficient visibility to make coherent bids between the two phases, to the extent that allocation rules are similar between the non-binding phase and the binding phase of the Open Season.

3) Allocation Rules

In the public consultation, a great majority of contributors have expressed themselves in favour of the allocation rules proposed by Elengy.

CRE sees the considered allocation rules as very similar to the ones CRE approved in January 2010 and applied during the 2010 Open Season. The only difference is that profiles are defined with a quarterly precision instead of annual precision as decided in 2010.

Besides Elengy has announced a decrease in terminal capacity, for regulatory reasons, before the commissioning date of the new facilities[1]:

- The total capacity of the terminal will not exceed 5.5 bcm per year between 1st October 2014 and 31st December 2015;
- The total capacity of the terminal will not exceed 4 bcm per year between 1st January 2016 and the commissioning date of the reservoir.

Consequently, during this period, Elengy forecast a reduction of shippers' subscriptions on a basis of non discriminatory and transparent terms that are to be defined.

Elengy sent CRE a new version of the information memorandum integrating the evolution (annex C, clause 11.12).

4) Tariff Framework

The decree of 20th October 2009 set the tariff framework applicable to projects developing regasification capacities for regulated terminals.

In order to give all necessary information to the shippers willing to take part in the Fos Tonkin Open Season, CRE defines below its orientations concerning the tariff applicable to the Fos Tonkin projects.

a) <u>Revenue</u>

Important investments will be needed to ensure Fos Tonkin terminal revamping. The investments forecasted by Elengy are:

- €325m$_{2011}$ for the "Horizon 2035 haut" project, from which €125m$_{2011}$ are linked to the construction of a new reservoir of 160 000 cm;
- €255m$_{2011}$ for the "Horizon 2035 bas" project, from which €90m$_{2011}$ are linked to the construction of a new reservoir of 80 000 cm;
- €45m$_{2011}$ for the "Horizon 2020" project.

According to the tariff framework, the "Horizon 2035" projects are entitled to the 2 %-bonus over 10 years for the creation of regasification capacity exceeding the 20 % threshold.

According to the tariff decree, CRE will confirm the allowance of the bonus depending on the result of the Open Season.

[1] Clause 11.11 of annex C : specific conditions

b) *Incentive regulation mechanism for investment costs*

The market players who answered the public consultation mainly approved the level of subscription thresholds and the criteria for the indicative maximum unit tariff that Elengy selected. Nevertheless, they asked for a fairer sharing of the risks with the operator in case of a cost overrun, especially during the construction phase.

1. In the public consultation, three mechanisms were chosen to limit the risk the shippers bear in case of an overrun of the costs Elengy published:

- an exit clause in case of the forecasted investments that will be determined by technical studies in 2012 (FI_{TS}) would be 25% higher or more than the forecasted investments published in the Information Memorandum (FI_{IM});
- a cap of the bonus granted for the creation of regasification capacities up to €280m$_{2011}$ for the “Horizon 2035 haut” project and up to €210m$_{2011}$ for the “Horizon 2035 bas” project;
- the non-remuneration of the assets under construction beyond the year of the expected commissioning, except in a case of force majeure.

Relying on the result of the public consultation, CRE confirmed the mechanisms.

2. Besides, CRE decided the implementation of an incentive regulation mechanism to incite Elengy to contain the cost of revamping the terminal:

- if 90 % $FI_{TS} \leq RI$[2] $\leq$ 110 % FI_{TS}, the tariff will cover depreciation and remuneration (including bonus) in accordance with actual tariff framework;
- if RI < 90 % FI_{TS}, the tariff will cover depreciation and remuneration (including bonus). Moreover, if $RI \leq FI_{TS}$, Elengy will get a bonus corresponding to a remuneration (including bonus) on the difference between the RIC and the FI_{TS};
- if RI > 100 % FI_{TS}, the overrun will be considered as follow:
    - for the overrun included between 110% of the FI_{TS} and 150% of the FI_{IM}, the tariff will cover depreciation and remuneration on the unique basis of the asset under construction rate applied to LNG terminal activity, provided provision to CRE of documentary evidences that the overrun is due to force majeure or very significant variation of the cost of core components;
    - for the overrun over 150 % of the FI_{IM}, the will cover depreciation only.

CRE could audit the FI_{TS}, especially is higher than 125% of the FI_{IM}. The reference date to calculate the difference between the RI and the FI is 31 December 2019.

c) *Accelerated depreciation*

The market players who answered the public consultation did not express objections to a mechanism accelerating depreciation for the “Horizon 2020” project.

CRE is in favour of a total coverage of the costs incurred by the “Horizon 2020” project through accelerated assets depreciation in the next tariff, what would lead to an approximate unit tariff of 1.4 €/MWh on the basis of Elengy estimated costs.

d) *Renegotiation clause*[3]

The market players who answered the public consultation are in favour of the renegotiation clause but express concerns about the calculation formula of the compensation associated to the clause enforcement.

[2] RI = realized investments
[3] Appendix C article 11.11

Following the public consultation, Elengy suggests a new calculation formula for the compensation that would be paid by a shipper eager to activate the renegotiation clause if its demand leads to the final stop of certain equipments of the terminal or of the terminal itself. Compensation will take into account:

- The amount actualized at the WACC that Elengy should have perceived between the date the shipper leaves the terminal and the initial end date the shipper committed for. The expenditures will be calculated in accordance with the tariff framework in force and will be deducted from prospective revenues linked to new subscriptions over the considered period;
- The money already spent for assets that will never be commissioned as a result of the shipper's demand;
- A provision endowment for dismantling.

CRE is in favour of the renegotiation clause and the calculation formula of the associated compensation.

IV. Decision

CRE asks for the following modifications concerning the Open Season procedure proposed by Elengy:

1. A change in the schedule according to paragraph III.1.
2. Taking into account the evolution of the compensation calculation formula associated with the activation of the renegotiation clause by a shipper as described in paragraph III.4.d.

The regulator approves the Open Season procedure proposed by Elengy, which is composed of the Information Memorandum (see annex A), the Allocation Rules and their annexes (see annex B and annex C), modified according to the above adjustments.

In addition, CRE decided the following guidelines regarding the tariff of the "Fos Tonkin" projects:

1. The "Horizon 2035" projects will benefit from a 2% bonus over 10 years up to €280m$_{2011}$ for the bigger project and up to €210m$_{2011}$ for the lower project, provided the Open Season stays within the range of the Information Memorandum, the Allocation Rules and their annexes, modified according to the above adjustments.
2. In case of a delay after the 1st October 2017 that is not linked to force majeure duly justified by the operator, the compensation will not go beyond the forecasted commissioning year.
3. The differences between the forecasted investments and the realised investments made on 31st December 2019 will be treated as described in paragraph III.4.b of this deliberation, which aims to provide financial incentives for Elengy to contain the cost of revamping the terminal. These amounts will be subject to inquiries by the CRE, if necessary through an audit.

V. Annexes

Annex A:
"Open Season Fos Tonkin 2011 – Information Mémorandum", 13th July 2011;

Annex B:
"Open Season Fos Tonkin 2011 – Allocation Rules", 13th July 2011.

Annex C:
"Subscription Agreement – Specific Conditions", 13th July 2011.

Signed in Paris, 7th July 2011

For the Energy Regulation Commission

Frédéric GONAND

Commissioner