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ExxonMobil
Gas & Power Marketing

14 October 2010

Implementation of EU Internal Energy Package and Licence Modification Appeals

Third Package Consultation Team
Department of Energy and Climate Change
Area 4C
3 Whitehall Place
London
SW1A 2HD

Dear Sirs

ExxonMobil International Limited is responding to both of the above, related, consultations primarily on behalf of its gas shipping and wholesale marketing entity, ExxonMobil Gas Marketing Europe Limited (though points on Licence modification and appeals processes apply equally to other licences held by ExxonMobil entities).

Our area of focus is in the wholesale market in Great Britain, where we sell gas sourced from both pipelines and LNG, and our response is for the main part focused to reflect these interests.

Of all the questions that DECC raises in its consultation the one that concerns us the most is its Question 7 in relation to proposed changes to the collective licence modification process. We are concerned that some of DECC's arguments for change are weak if not factually inaccurate, and DECC's follow up consultation issued 1st October suggests that the approach to this important aspect of the consultation is at best piecemeal.

It is important that Ofgem are provided with sufficient enforcement powers to implement required changes so that that the regulatory process is efficient and effective, and it is equally important that licensees (and indirectly consumers) remain protected against excessive or poor rulemaking. The argument for such a balance has been made in Parliament as recently as January 2010, when Joan Ruddock, speaking as Minister of State in a House of Commons Public Bill Committee debate on what became the Energy Act 2010, defended the current collective licence modification process, stating that the Electricity and Gas (Modification of Standard Conditions of Licences) Order 2003 struck a balance between making it quicker and easier to alter standard licence conditions and ensuring that when a significant proportion of licensees object to a proposal, their objections are taken into account.

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Our further comments on this particular consultation question are given ahead of responses to other questions:

Q7. Implementing binding decisions. For the reasons we have set out in the consultation document, the Government proposes to replace the current collective licence modification objection arrangements with a process that allows Ofgem to reach its decisions subject to appeal to an appropriate body. This would reinforce Ofgem's power to make decisions in accordance with their powers and duties under the Third Package, and would give all licensees the same right of appeal. Ofgem's decisions, as now, would need to be reached following consultation and subject to the principles of better regulation. This proposal would include all Ofgem licence modification decisions and not only those covered by the Third Package. We would be grateful for your views on these proposals.

In sections 4.40 to 4.43 of the consultation document, DECC refers to **new** requirements which set out a clear expectation that the national regulatory authority (NRA) will be able to make decisions independently and will be able to implement them in an efficient and expeditious manner. DECC sets out its view that the current collective licence modification process does not provide an **effective and expeditious** way for Ofgem to exercise its functions in the way envisaged by the Third Package and proposes to replace the current process with one that allows Ofgem to reach its decisions subject to appeal to an appropriate body.

We would point out that **neither** the requirement that the NRA be independent of industry interests **nor** that the NRA should have powers to implement its duties in an efficient and expeditious manner are **new requirements**. Both of these requirements were set out in Articles 25(1) and 25(7) of Directive 2003/55/EC:

Article 25(1) Directive 2003/55/EC

Member States shall designate one or more competent bodies with the function of regulatory authorities. These authorities shall be wholly independent of the interests of the gas industry.

Article 25(7) Directive 2003/55/EC

Member States shall take measures to ensure that regulatory authorities are able to carry out their duties referred to in paragraphs 1 to 5 in an efficient and expeditious manner.

By way of contrast the Directives do introduce a **new** requirement to ensure that the NRA is able to take "autonomous decisions, **independently from any political body**."

The point that we wish to make here is that the only major new requirement is that the NRA be free of Government or political influence – independence from industry interests has been a requirement since 2003, no-one has seen fit to propose a change to the collective licence modification process since then, and the question as to why DECC are proposing a substantive change to the collective licence modification process now remains unanswered.

Returning to the matter of how to ensure a balance between efficient and effective regulatory change whilst avoiding the risk of poor quality or excessive rulemaking: Ofgem currently has the ability to refer licence changes that it wishes to make for independent review by the Competition Commission – this is a powerful right and Ofgem should be expected to use it when it is otherwise concerned that vested licensee interests might try to frustrate a legitimate change proposal during the normal consultation process. This right has existed for as long as the collective licence modification process itself and whilst it may on those occasions it is used act to slow down the change process, we would argue that this is preferable (on contested or complex decisions) and more efficient than implementing a decision that is then subsequently challenged. Given that DECC appears minded to allow the appeal body suspensive powers under the proposed new regime, the time that elapses for a licence modification, between first being proposed and finally taking effect after a challenge, may well be broadly similar under the existing regime and the current proposal from DECC.

Since the consultation of 27th July, DECC have followed up with a special consultation (October 1st) entitled "**Consultation on Licence Modification Appeals**" and we will use this opportunity to provide our initial thoughts on the new proposals and arguments presented by DECC for a modified process, notwithstanding the fundamental question we have raised above as to whether the argument for any change at all has been properly made.

Should a clear argument for change be presented in the first place, we would be inclined to agree with some of the suggestions made by DECC:

- It would be inefficient and unnecessarily complex to have two parallel processes (i.e. one for EU, one for domestic) for making licence modification decisions;

- The market share test is difficult conceptually and this leads to concern about some licensees having the ability to act alone;

- There may need to be a different appeals process for price control reviews and this should be a full investigative hearing;

- Building in flexibility to allow the Competition Commission (or more precisely the appeal body) to be able to vary non-price control decisions of Ofgem would seem sensible provided that the exercise of those powers is not a mandatory requirement.

The appeal body should, in our view, have suspensive powers, and the mechanism proposed for recovery of costs seems sensible.

As noted above, Ofgem has the ability to refer licence changes that it wishes to make for review by the independent Competition Commission, and the process for licence modifications as a whole can therefore already be considered independent. One way, however, of addressing the concern around a licensee acting alone to frustrate legitimate licence modifications would be to remove the market share test and to lower the threshold for non-objectors. With such changes, the NRA could be said without any question to be functionally independent from any specific public or private entity (under Article 39(4)(a) the NRA must be legally distinct and functionally independent from any other public or private

entity). However, in removing the market share test, there is some risk that a count of non-responding inactive licensees could frustrate the proper functioning of the voting process. The voting would need to consider only "active" licensees, and "active" would need to be carefully defined.

These thoughts are offered as our initial thoughts in respect of the 1st October consultation and we may respond more fully by the 29th October closing date.

Returning to the remaining questions in the 27th July 2010 Consultation, we have selected below those questions on which we wish to provide a response.

LNG Related Questions

Q6 Should the Gas Directive requirements for storage and LNG operators be introduced through a new licence regime or by amending existing legislation? Please provide evidence of costs and benefits wherever possible.

A new licensing regime for LNG and storage operators is not a necessary requirement of the Third Package; it would be sufficient, and preferable, to fulfil the requirements of the Third Package through amendments to primary legislation.

Whilst it might seem neater to have a system of licensing for LNG and storage facility operators DECC should be mindful that this would be perceived not as EU regulatory creep but as GB regulatory creep. It would increase uncertainty unnecessarily. Moreover, we are not aware of any specific GB reason for the tighter regulatory control that a licensing arrangement implies, and in any event LNG terminals in Great Britain are already subject to the terms of their exemption orders under the Gas Act 1986. These exemption orders provide Ofgem with some ability to enforce (for instance) the transparency requirements of Gas Regulation 715/2009.

The relatively small number of changes required by the Third Package in relation to Exempt LNG terminals should lead to a correspondingly small number of changes in the primary legislation (which may include some enforcement provisions).

Finally, DECC state that if they licensed storage and LNG system operators, they would consider the designation requirement to be a part of that activity. We would argue, by analogy, that an LNG system operator could be treated as designated by virtue of its Gas Act 1986 Section 19C exemption. In any case, assuming that the objectives of the Third Package that relate to gas storage and LNG facilities are implemented in the UK by legislative changes (with no specific licensing regime), then the legislation could in any case provide for a regime similar to that under section 27 of the Petroleum Act 1998 for designating pipeline owners.

Q21 Article 22 of the Regulation outlines the requirement for contracts and procedures to be harmonised at 'technically and economically necessary' LNG and storage sites. What changes to current practices will, in your view, be required to achieve this and what are the likely costs of making these changes?

We are not aware that any of the LNG terminals would be considered "technically and economically necessary" assuming this has the same meaning as "essential facility". There are three major LNG terminals in GB, and all compete to provide unused terminal capacity or regasification services to LNG suppliers. For LNG we therefore do not believe that any changes to current practices are required.

Q22 We would welcome evidence on the costs and benefits of introducing a licensing regime for LNG and storage as opposed to introducing the measures through changes to legislation.

Licensing of LNG system operators introduces some increased threat of future, as yet undefined, regulation without the scrutiny that attaches to the alternative route of changes made to primary legislation. There is no evidence of any failure on the part of LNG system operators to comply with their current obligations and therefore we doubt that a licensing regime would provide any benefit for GB consumers at this juncture.

Other Points

At section 1.21 of the consultation document, DECC proposes that consumers should be able to take legal action for breach of contract at an early stage if suppliers do not meet the obligation to switch consumers within three weeks, after the end of the 14 calendar days' cooling off period. While not a point of significance for ExxonMobil's business, we wonder whether a more appropriate remedy would be to provide for compensation to be payable under the Electricity (Standards of Performance) Regulations 2005 and the Gas (Standards of Performance) Regulations 2005.

DECC appear to have already concluded in their consultation document that any new duties for Ofgem under the European legislation will be in addition to rather than instead of those already existing. Sections 4.26 and 4.27 state:

- "4.26 The requirement to pursue the article 36 objectives will be in addition to rather than instead of the existing principal objective and general duties, which would remain in place and continue to apply.

- 4.27 The Government's view is that all of the other matters which Ofgem currently has to have regard to in the remainder of sections 3A of the Electricity Act 1989 and 4AA of the Gas Act 1986, would continue to apply as now (subject to conflict with article 36 objectives when Ofgem is performing a regulatory task)".

In our earlier response to the Call for Evidence (Ofgem) we questioned the wisdom of simply "adding" to Ofgem's duties without examining how these sit with existing statutory duties. In the context of NRA autonomy and independence required under the new Gas and Electricity Directives, we urged DECC in that response, repeated here, to consider some further questions:

- Whether there are any areas where Government's energy/social/environmental general guidance to Ofgem encroaches on the NRA's independence and autonomy;

- The extent to which Government may be inadvertently providing instruction to Ofgem on the formulation of parts of its budget - specifically in relation to E-Serve. In the interests of transparency and public record Government should consider giving Ofgem the opportunity to explain and debate within Parliament the source of its budgetary plans and priorities.

- The extent to which Ofgem's existing statutory remit may be so UK-centric as to compromise or limit its ability to help promote a competitive, secure and environmentally sustainable internal market for electricity and gas in Europe.

- Whether Ofgem's current statutory remit in any way limits its freedom to seek further transparency improvements for the benefit of consumers.

We trust that DECC will take these comments into account; please do not hesitate to contact us if any clarification is required.

Yours sincerely,