Poles apart

01/07/2005

The billions of dollars pouring into upstream LNG projects in the Middle East is beginning to manifest itself further down the supply chain in the form of LNG regas terminals across Europe. But contrary to the EU mantra of a single market, sponsors are finding some national jurisdictions more welcoming to prospective LNG regas investment than others.

The most recent European deal – financing for the Southhook, Milford Haven terminal in the UK (the downstream end of the Qatargas 2 project) – went smoothly. The deal benefited from strong sponsors – Qatar Petroleum (QP) and Exxon – that acted across the whole supply chain down from the Qatargas II plant, and the terminal was granted an exemption to third party access rights.

The whole Qatargas project was applauded for pioneering a new integrated supply chain model. And although it is widely accepted by the market that QP's move downstream was more a function of necessity than design, other sponsors are now also moving across the supply chain to ensure expeditious commissioning and to excise the knotty problems of inter-shareholder and inter-creditor agreements.

Spain's central pot

The next regas terminal financing in Europe is likely to be the Reganosa terminal in Galicia. It is the third terminal under new Spanish regulations that implemented the EU Directive 98/30 on unbundling and creation of a liberalised gas market. Spain implemented this directive under the Hydrocarbons Sector Law that gives LNG terminal sponsors and lenders favourable terms.

When a terminal receives its authorisation for commissioning the Ministry of Economy allocates an annual revenue allowance to the terminal based on a standard set of costs plus reasonable return over the lifetime of the asset. The reasonable rate of return is pegged to the 10-year government bond plus 150bp.

On a practical level, terminals receive monthly revenues direct from the regas users of the terminal facilities – the users are shippers of which the incumbent Gas Natural dominates the market – and will pay a uniform tariff rate no matter which terminal it uses.

Under a framework set up under a ministerial order the uniform tariffs are updated yearly and are incrementally updated with a formula that captures inflation. However, the government has indicated that it will review the base amounts this year. Market feeling is that although some components will go down, their sum will increase. At present the tariffs are Eu544.34bcm/yr for storage facilities, Eu204.27bcm/hr of nominal regas capacity, and Eu1.68 million/year per system loading base facility.

The revenues are effectively paid from a single pot, because at the end of the year the regulator, Comisión Nacional de Energía (CNE) with the Ministry of Economy makes a settlement to each system agent equal to the remuneration due minus the amount of income. It pays or collects from each terminal so that in theory the total income in the system equals the total remuneration due.

In the event of a shortfall, the sum is carried forward to the next year and an increase in tariff should ensue.

In practice it is possible that the revenue accruing to regas plant owners after the settlement differ from their full annual allowance as a function of the utilisation rate. The current remuneration system sets the annual revenue allowance with reference to a utilisation rates of 75% of the nominal regasificacion capacity of each plant. Utilisation rates below (above) this threshold reduce (increase) the annual allowance for the part of variable costs related to the difference between the actual utilisation rate and the 75% reference.

There has been some debate as to whether the 75% threshold is too high. Dr Fabrizio Hernandez, associate director at NERA says: "It is clear that by setting the threshold at 75% a signal is sent to the market that the regulatory regime will not accept terminals that are likely to operate with excess spare capacity. It is important though that the threshold is set at a level that does not put cost recovery at risk."

Under the Hydrocarbons Sector Law the regas sponsors may allocate 75% of the regas capacity to long term contracts (Regasification Services Agreements) with 25% available for contracts shorter than two years in duration. The rationale of the provision is to help market liberalisation of the internal gas and electricity markets and encourage the burgeoning spot market.

Lender comfort

Three deals in and lenders are now more comfortable with this system. No wonder. Given the low technology risks and the comfortable regime, "taking a slice of a Spanish regas deal is less about taking project risk and more about taking Spanish regulatory risk," says one banker.

The regime effectively takes the terminal owners under its wing, with its allocated revenue cross-subsidised by other participants in the system. Although there is a variable component based on usage, the fixed component is safe unless it can be shown that unavailability for regas was within sponsor control.

The raison d'etre behind the centralised pay-and-distribute pool is to unbundle ownership of LNG terminals from incumbent distributors and the vertically integrated major oil and gas and utility companies, to some extent by decoupling market risk from terminal ownership. That Reganosa LNG has a milieu of different shareholders is testament to this. Nevertheless, having majors and utilities as shareholders on board does however help to ensure that a certain amount of through-gas is already guaranteed. The law also helps to ensure security and diversity of Spain's gas supply.

The uncertainty surrounding the regime evaporated with the close of two LNG terminal financings: the BBG plant sponsored by BP, Repsol, Iberdrola and EVE and the Sagunto plant sponsored by Union Fenosa, Endesa and Iberdrola. Mainstays in both these projects were the EIB and MBIA, and the ratings agencies – however none of these will be involved in the forthcoming financing for the Reganosa terminal in Galicia.

A spokesperson in the EIB said that the bank was pleased it had catalysed the commercial banks into acting on their own, to accept longer dated debt and rid concerns of the regulatory regime.

Reganosa is sponsored by Endesa (21%), Union Fenosa (21%), the regional authority, Xunta de Galicia (10%), Grupo Tojeiro (18%), Sonatrach (10%), Caixa Galicia (10%), Banco Pastor (5%) and Caixanova (5%).

Part of the terminals usage will be assured by the gas offtake to two combined-cycle power stations that Endesa and Union Fenosa are planning in As Pontes de Garcia Rodriguez and Arteixo, respectively.

The anticipated Eu360 million financing has been shrouded in secrecy, but is expected to close soon. A lead arranger group of about six banks is anticipated to underwrite a three to six month bridge whilst a long term bank facility is negotiated that is destined to smash the 20-year-maximum unwritten rule for Spanish infrastructure debt – the tenor touted is as long as 25 years. The debt is likely to be priced at well under 100bp.

A creeping risk, which some gas analysts are forecasting, is a gas glut in Europe in the next five to 10 years. Terminal capacity across the board could come under pressure from other terminals as well as improved interconnection capacity with France and Algeria and internal distribution. The three post-regulation LNG terminals are listed category A by the

Ministry of Economy of high importance – the Medgaz pipeline project from Algeria has recently been upgraded to category A, of urgent importance, from category C.

But this could be dismissed as a doomsday scenario. Although there is a risk of overcontracting, given the flexibility in shipping and the number of European LNG terminals there is unlikely to be an oversupply. There may be a dip in usage when Medgaz comes online but this is unlikely into the long term.

The principal credit weaknesses in a project financing of a Spanish LNG terminal are corporate regas market user risk and Spanish regulatory risk. In a distant third there is some market risk through utilisation of the terminal in the variable component of the revenue payment.

Italian rush

There are also concerns of supply outstripping demand in the medium term in the Italian gas market. This for the moment, however, seems some way in the distance. Italy currently has six prospective LNG terminals and it is difficult to call which will reach financial close first.

The Brindisi terminal is currently the most advanced – it has all the requisite authorisations, it is technically most advanced, and the financing is closest to being put in place. However, the sponsor BG was dealt a blow with the recent withdrawal of incumbent Enel from the terminal both as a shareholder and as an offtaker.

The reason for Enel's Eu44 million divestiture and the probable rock on which the project could founder is local opposition. Enel's recently appointed CEO, Fulvio Conti has gone on record as saying Enel has other opportunities for gas imports and that the sale was because of local problems despite having approvals from national authorities.

A well-connected Italian lawyer also says that Conti is looking to streamline Enel and concentrate on generation, and is attempting to divert regional political heat after coming under fire for plans to commission coal-fuelled plants. Still, the incumbent appears to be betting that the terminal will not happen or it is very short-termist as Enel is likely to be a potential buyer of gas that goes through Brindisi.

The Brindisi LNG terminal is perhaps unique in uniting Italian communists with Berlusconi's centre-right – Apulia's communist president Nichi Vendola and Brindisi's rightist mayor Domenico Mennitti are aligned in their opposition to the terminal. Locals protest that Brindisi, already heavily industrialised, has borne its fair share for the country. The Brindisi port is currently home to coal-fired power station, a military fuel store and a petrochemicals plant.

Floating through – probably not

Despite these difficulties a spokesman from BG is adamant the terminal will go ahead, with BG gas marketing offtaking 80% of the capacity and third party access to the residual 20%. The Eu390 million terminal should begin importing LNG, up to 8bcm/yr, in 2008. But despite high-level talks between UK prime minister Tony Blair and Berlusconi underlining the strategic importance of the plant, without an Italian partner BG's chances look chequered at best.

So if it's not the Brindisi terminal first, which will it be? Although the floating Eu400 million 4bcm/yr Livorno terminal looks set for fresh impetus given the 51% stake purchase split equally among Endesa and AMGA, project financiers on the ground in Italy are sceptical given the history of shareholder infighting in the Italian camp.

The infighting concerned control of the project company. The MD of CrossGas, Paula Belleli, took Falck to court – the result went against Falck and it picked up a bill in legal fees of some Eu500,000. Paola Belleli is the wife of famous industrialist Aldo Belleli who went bankrupt in 1996 and cost a lot of domestic banks a lot of money.

It is probable the new investors knew of these problems when they bought the stake, and may be able to keep the project on course with a controlling stake. However, the project company may have reputational issues when approaching banks. LNG terminals are hard enough to get off the ground without arguments among shareholders.

The market favourite to be first through the financing red tape is the Exxon, QP and Edison sponsored Rovigo terminal.

The terminal has strong sponsors and will be buoyed by the success of the bumper QatargasII upstream financing and the Southhook terminal financing. It is all a question of lobbying, at both national, regional and municipal level.

Opaque regs

As well as taking a punt on which terminal will be the first to finance, Italian market observers are also speculating as to what guise the Italian regulatory regime will take.

Italy currently has only one small LNG terminal at Panigaglia owned by GNL Italia and operated by Snam, producing 190mcf/d of natural gas. With a host of prospective LNG terminals in the offing (see box), Italy will have to create a reasonable regulatory regime.

The Italian industry ministry, the Ministero delle Attivita Produttive (MAP) is likely to determine in August via a decree the route Italy will follow. Unlike the Spanish system the Italian authorities are likely to only loosely follow the EU directive. This will mean that long term bilateral regasification services agreements, on the back of long-term gas SPAs are likely to underpin most LNG project financings.

It will also mean that parties to such contracts can set their own prices. As a consequence this may distort prices across the region depending on the proximity to particular LNG terminals and internal bottlenecks.

For instance Edison has tried to placate the regional authorities by signing a supplemental protocol in which it agreed to provide more favourable gas purchase terms to users located in the province of Rovigo and grant a pre-emptive right to purchase natural gas regasified at the terminal to industrial-district associations located in the Veneto region.

Without a cross-subsidising regime more terminal sponsors are likely to push for an Article 22 exemption under the EU directive that allows a development without rights of third party access. Such an exemption will allow the sponsors to tie up long term contracts for as much as the capacity as possible to secure decent margins and leveraging on a project financing.

Perhaps more pertinently, an ad hoc approach along these lines signifies that the authorities do not believe the country needs more than one or two more LNG terminals.

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Medgaz – a worthy adversary

Medgaz is a deepwater pipeline, stretching from Beni Saf in Algeria up to the Spanish coast of Almería. It will have an initial capacity of 8bcm per year. Measuring 200 kilometres in length, Medgaz will reach a maximum water depth of 2,150 metres.

Medgaz's shareholding structure includes the project's promoters – CEPSA (20%) and Sonatrach (20%)- in addition to BP, Endesa, Gaz de France, Iberdrola and Total, each of which holds a 12% interest. The project has moved from the feasibility stage, to the implementation stage and will be about 18 months to financing. The gas into Spain from the pipeline is expected to be cheaper than gas from any other source.

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Italy's wish list?

Italy currently only has one LNG terminal, located at Panigaglia on its West coast near La Spezia.
Of the prospective terminals, Brinidisi sponsored by BG is the most advanced but is having problems with local opposition.

ExxonMobil and QP each hold 45% stakes in the proposed North Adriatic LNG project, an effort led by Italy's Edison to build an LNG receiving terminal on Italy's northern Adriatic coast. The project company has received primary authorisations and is looking to woo locals with promise of cheap gas.

Livorno could become the LNG capital of Italy. The Offshore LNG Terminal (OLT) consortium has received environmental approval for its proposed LNG receiving terminal near Livorno. OLT should benefit from the impetus of Endesa and AWGA as new shareholders – the other shareholders, Falck, Golar LNG and Italy's CrossGas. There has been some infighting in the Italian camp that is likely to delay proceedings.

BP, Edison, and chemical company Solvay plan to construct a terminal on the site of a former Solvay chemicals plant near Livorno. In January 2005, Italy's environmental ministry approved plans for the construction of the project. Like the Brindisi terminal, however, local opposition is hindering progress and the project has gone quiet.

Spain's Gas Natural (GN) plans to construct two terminals, one in Trieste and the other in Taranto. GN plans to complete the projects by 2009 – but it is still at the first stages.

Also taking the first steps into Italian LNG, Royal Dutch/Shell announced in the first quarter 2005 that it is partnering ERG to build an LNG receiving terminal next to ERG's oil refinery at Priolo Gargallo, Sicily.

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Third party rights exemption

For an Article 22 exemption, an application must be made to the regulator and then to the Commission. Several conditions must shown if the exemption is to be successful: the terminal enhances competition and security of supply; the risk involved is high enough that without the exemption the investment could not go ahead; charges for services are paid by the users; it does act against the EU legislation and ethos of internal gas markets; and the owner is a separate legal entity from the system operator.