



Gas shippers, gas transporters
and other interested parties

*Promoting choice and value for
all gas and electricity customers*

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Date: 12 August 2011

Dear Colleague

Consultation on Glenmavis Liquefied Natural Gas facility

National Grid (NG) owns the Glenmavis liquefied natural gas (LNG) facility. Historically, this site has provided a combination of commercial storage services to gas shippers and price regulated services to both National Grid Gas (NGG) and Scotland Gas Networks (SGN).

In December 2010, the Glenmavis facility developed a suspected leak in the cold box and had to suspend its liquefaction process. Whilst Glenmavis was able to fulfil its supply requirements to the end of the 2010/11 storage year, its capability in the next couple of years is subject to a number of uncertainties. As a result it was excluded from the scope of the LNG Price Control Final Proposals¹ which the Authority² has approved.

This consultation details the proposal for Glenmavis to be used as a buffer tank for the 2011/12 storage year for the purposes of serving the needs of the Scottish Independent Undertakings³ (SIUs), in order to secure supply to these vulnerable communities. **We are seeking responses to this consultation by 23 September 2011.**

Background to regulated service at Glenmavis

NG LNG facilities

Glenmavis is one of five LNG facilities⁴ that were sited at strategic points in the transmission network in the mid 1970s, as an economic alternative to network reinforcement. These facilities were separated out from the regulated operations of NGG in the late 1990s⁵, in order to promote contestability in the provision of operating margins (OM)⁶. The Glenmavis facility is owned and operated by National Grid LNG ("NG LNG").

¹ LNG Storage C3 price control – Final Proposals", Ofgem ref A11/18, 21 February 2011

² Ofgem is the Office of the Gas and Electricity Markets Authority. The terms "Ofgem", "the Authority", and "we" are used interchangeably in this document.

³ These constitute four remote towns in Scotland which are not on the main gas grid. They are supplied with LNG which is delivered by road tanker.

⁴ Glenmavis, Partington, Avonmouth, Dynevor Arms and Isle of Grain LNG facilities.

⁵ The Isle of Grain site was subsequently converted to an import terminal

⁶ OM gas is used to maintain system pressures when the system has been put under stress until other system management actions become effective. There are several providers of these services to NGG, other than the NG LNG sites.

We have continued to price regulate the provision of OM services by NG LNG to NGG and shall continue to do so until Ofgem is in a position to remove the current price cap for the provision of OM services as specified in Special Condition C3 of NGG NTS' licence⁷.

Glenmavis LNG regulated services

The Glenmavis facility has been used to supply OM services to NGG and supply LNG to SGN to serve the needs of the SIUs. The SIUs comprise four independent gas networks that serve about 7,600 consumers that are located in remote regions of Scotland; namely, at Wick, Thurso, Oban and Campbeltown. They total around 91km of pipes, which are supplied with re-gasified LNG. Whilst these SIUs are not physically connected to SGN's main distribution network, SGN are responsible for maintaining and supplying the SIUs.

The LNG for SIUs has primarily been sourced from the Glenmavis LNG site, and then transported by road tanker to smaller local storage sites. Avonmouth and Partington have acted as back-up sources whenever Glenmavis has been unable to provide LNG.

NG LNG closed Dynevor Arms in 2008 and announced the withdrawal of commercial storage services from the Partington and Glenmavis facilities in 2010. Glenmavis facility suspended its liquefaction process in December 2010. NG LNG confirmed that it would withdraw regulated services from Glenmavis from May 2011. Consequently Avonmouth is the single source of liquefaction in GB as Isle of Grain was converted into a LNG importation terminal in 2005. Accordingly, since May 2011, SGN have been sourcing the LNG required to supply its SIU customers from Avonmouth. Sourcing from Avonmouth increases the distance to the SIU consumers by up to three times and also raises security of supply issues. See Appendix One for a map of the relevant SIUs and LNG facilities.

SIU funding arrangements

The cost of supplying LNG from the Glenmavis facility to these four networks is subsidised through a charge levied by NGG on all shippers, so these costs are no higher than the average GB gas transportation charges. The subsidised charge covers the cost of booking capacity at a LNG storage facility, the cost of LNG tanker filling and the cost of transporting the LNG to the SIUs.

This subsidy is in accordance with a Direction from the Secretary of State issued on 19 March 2008. The arrangement will lapse with the end of the current gas distribution price controls⁸ on 31 March 2013.

This charge, which has historically amounted to £5.4m pa (in 05/06 prices), is then passed from NGG to SGN (through the operation of Special Condition C26 of the Gas Transporter Licence⁹) to fund the LNG tanker filling and transportation costs. The cost for operating and maintaining these SIU networks is funded separately through SGN's price control.

Current Situation

The Glenmavis facility had an expected operational life until 2015. The sudden failure of Glenmavis requires SGN to bring forward plans for an enduring supply solution for the SIUs. Arrangements also need to be put in place to maintain the supply to these networks until the long-term solution can be implemented.

⁷ For further details on this issue, see Operating Margins (OM) Contestability 2010/11 – Open Letter, 21 December 2009

⁸ We understand that the Department for Energy and Climate Change will be consulting on the future options around these subsidy arrangements later in this year.

⁹ This condition also covers certain subsidies in relation to independent networks that are supplied with Liquefied Petroleum Gas

Maintaining supplies in the short term

SGN considers that there would be significant risks to the security of supply for the SIUs in winter 2011/12 if it were to rely on the regular tankering of gas from Avonmouth. Since the local LNG storage capacities of the SIUs are limited and are not readily capable of expansion, SGN has considered a range of supply options that can be implemented in time for the 2011/12 winter.

SGN is proposing to use one of the Glenmavis storage tanks as a buffer store. Under this proposal, SGN will use tankers from Avonmouth to fill Glenmavis during the summer, such that travel distance to the SIUs in winter would be consistent with the current arrangements. These arrangements have been put in place since the start of the storage year 2011/12.

The enduring supply situation

SGN are evaluating a range of options for the longer-term supply of these networks, including lower carbon alternatives. We expect a fully-justified enduring supply proposal which can be implemented in time for winter 2012/13 to be presented to Ofgem in autumn 2011. In this regard, it is worth noting that the Department for Energy and Climate Change (DECC) intends to consult on whether the existing cross-subsidy arrangements for SIUs should extend beyond the current 2013 cessation. We expect this consultation to take place in the latter part of this year.

Funding the changes

As explained earlier in this letter, the cost of transporting LNG to these networks is subsidised through a charge levied by NGG on all shippers. This charge for 2011/12 currently stands at £5.4m pa in 05/06 prices (£6.8m in 2011/12 prices). It is paid by NGG to SGN (through the operation of Special Condition C26) to fund the LNG tanker filling and transportation costs.

Funding short-term changes

The prices charged by NGG to SGN for liquefaction, storage space and tanker loading are also restricted to those specified in Special Condition C3 of NGG NTS's licence. The switch to sourcing LNG from Glenmavis to Avonmouth, along with the revised regulated prices as a result of the recent NGG LNG price control, has resulted in a change to SGN's costs in providing services to the SIUs. In the Gas Distribution Price Control Final Proposals we said that consumers should underwrite any such costs arising from changes to the regulated prices in Special Condition C3¹⁰ of the Gas Transmission licence. Avonmouth C3 prices have increased; the Avonmouth booking costs are £3.5m for 2011/12.

The effect of additional transport costs (£1.1m) and the cost for maintaining the Glenmavis site for the purposes of being a storage buffer during 2011/12 (£7m¹¹) brings the total funding increase required to £11.6m (in 2011/12 prices).

We believe that in order to ensure the SIU consumers' security of supply for winter 2011/12; it is appropriate to allow this additional funding of £11.6m. These costs are in line with historical levels that have been subject to cost assessment through two previous price controls. We recognise that there were a limited number of short-term solutions available to SGN that would not have compromised the SIUs' security of supply.

¹⁰ Gas Distribution Price Control Review Final Proposals Document (8.25)– Ofgem Ref 285/07, 3 December 2007

¹¹ This figure is based on the recent average efficient running costs for the Glenmavis site, excluding long term capex investments. We believe this is a proportionate approach to the cost assessment given the nature of the situation and timing involved.

Providing this funding is consistent with the Secretary of State's direction that the transportation costs of LNG for these consumers should be subsidised until the end of the current price control period, so that they can benefit from the effects of gas competition.

Funding the enduring solution

As previously mentioned, SGN is still evaluating the options it has to implement an enduring solution. As such, to date we have only had indicative costs of preferred options. The funding arrangements for this should be dealt with under both the existing control and the forthcoming RII0-GD1 control. We expect the preferred solution to be both lower cost and lower carbon than the current arrangements.

Later this year DECC will be consulting on whether to continue with the cross-subsidy arrangements for the SIUs. This may have an impact on SGN's enduring solution.

Proposal

We are proposing to modify Table 1 in Special Condition C26 of NGG's Gas Transporter Licence to reflect the increased costs of £11.6m imposed on SGN for the year 2011/12. We are also proposing to amend the definition of "independent system" within C26, to more correctly reflect both the policy intent and current implementation of the condition¹². A change marked version of this condition is attached as Appendix Two. The funding will only be permitted for the 2011/12 storage year; we expect that by the storage year 2012/13 SGN will have in place an enduring solution for the provision of energy to the SIU consumers.

Responses

We would welcome views or comments from interested parties. If you wish to make verbal comments, contact details can be found at the end of this letter. Any written comments should be sent to:

Natasha Ranatunga
Ofgem
9 Millbank
London
SW1P 3GE
gas.transmissionresponse@ofgem.gov.uk

Please submit responses both electronically (to the email address below) and in writing. Please put any confidential material in the appendices to your response. The deadline for all responses is 23 September 2011. Ofgem would expect to proceed to Section 23 consultation following consideration of respondent's views.

Unless marked confidential, all responses will be published on Ofgem's website www.ofgem.gov.uk and placed in its library. Respondents may request that their response is kept confidential. Ofgem shall respect your request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

Respondents who wish to have their responses remain confidential, should clearly mark the document/s to that effect and give the reasons for confidentiality.

¹² The Final Proposals for the current Gas Distribution Price Control specifically remove the costs for running the independent systems from SGN's allowance, on the basis that it is to be recovered through Special Licence Condition C26.

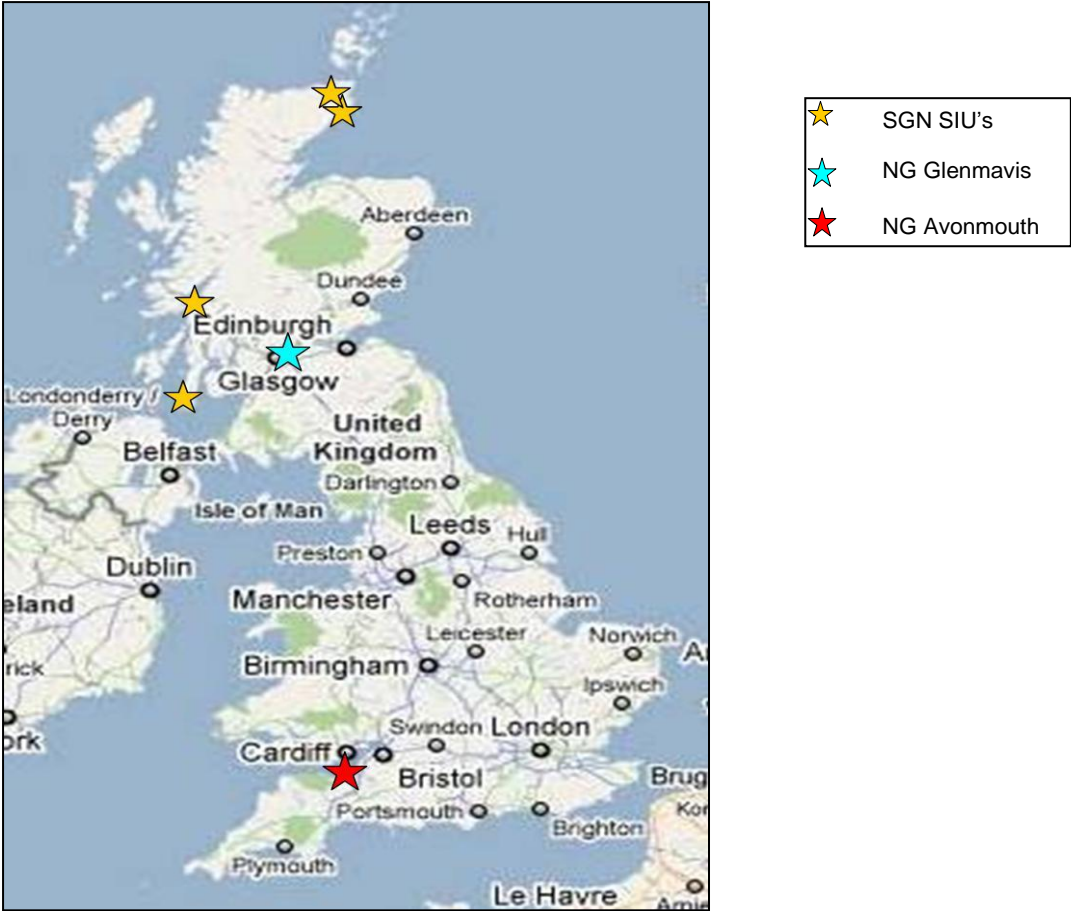
If you have any comments or questions on this letter, please contact Natasha Ranatunga on +44 20 7901 7183 or gas.transmissionresponse@ofgem.gov.uk in the first instance.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Rachel Fletcher', is positioned above a light grey rectangular box.

Rachel Fletcher, Partner, Distribution

Appendix One - Map of SIUs and LNG facilities



Appendix Two

Special Condition C26: Gas Conveyed to Independent Systems

1. Pursuant to the direction given by the Secretary of State on 19 March 2008, regarding the Continuation of the Cross-Subsidy Arrangements for Independent Systems (the "Direction") the licensee is required, until 31 March 2013, to comply with this licence condition.

Bulk Price Differential

2. The licensee shall, subject to it having received all the information it requires from DN operators to enable it to do so, by 30 April in each formula year, in respect of each independent system:
 - (a) make a reasonable estimate of the bulk price differential for that formula year (BPDE_t); and
 - (b) calculate, in formula years commencing on and after 1 April 2009, any adjustment (whether of a positive or a negative amount) (BPDADJ_t) in formula year _t which relates to the difference between:
 - (i) the estimate of the bulk price differential it calculated in the preceding formula year (BPDE_{t-1}); and
 - (ii) the actual amount of the bulk price differential in that preceding formula year (BPDA_{t-1})in accordance with the following formula:

$$\text{BPDADJ}_t = \text{BPDA}_{t-1} - \text{BPDE}_{t-1}.$$

For the avoidance of doubt, for the formula year commencing 1 April 2008, BPDADJ_t = 0.

3. The licensee shall, in respect of each independent system, pay to the relevant shipper an amount equal to a proportionate amount of the sum of the amounts calculated pursuant to paragraph 2 (BPDE_t + BPDADJ_t) quarterly (or at such frequency as may be agreed with the relevant shipper) during the formula year in which the calculation in paragraph 2(a) was made.

Distribution Network Additional costs payment

3. The licensee shall pay to the relevant DN operator the amount set out in Table 1 in respect of the additional costs to serve the independent system operated by that

DN operator (“additional costs payments”) denoted by “ACPS_t” and “ACPW_t”. Such amounts shall, prior to payment, be adjusted to take account of the change in the retail prices index between the formula year commencing 1 April 2005 and the relevant formula year set out in Table 1 in accordance with the following formulae:

$$ACPS_t = SGNACP_t \times ISPIT_t$$

and

$$ACPW_t = WWUACP_t \times ISPIT_t$$

Where:

ISPIT_t is the Independent Systems price indexation adjustment term which shall be calculated using the following formula:

$$ISPIT_t = \left(1 + \frac{RPI_t}{100}\right) \times ISPIT_{t-1}$$

Where ISPIT_t shall take the value 1 in respect of the formula year commencing 1 April 2005.

Where RPI_t shall be as defined in paragraph 8 and, for example and the avoidance of doubt, a RPI_t of 5% would be entered as 5 in the formula not 0.05.

Table 1

£m, 2005-06 prices	2008-09	2009-10	2010-11	2011-12	2012-13
Scotland Gas Networks plc (SGNACP _t)	6.0	5.4	5.4	<u>15.1</u>	5.4
Wales & West Utilities Limited (WWUACP _t)	0.1	0.1	0.1	0.1	0.1

5. The licensee shall pay to the relevant DN operator a proportionate amount of the additional costs payments for the relevant formula year on a quarterly basis during that formula year or as otherwise agreed with the DN operator to whom the payment is to be made.

Recovery

6. The licensee shall recover an amount equal to the aggregate of:
 - (i) the sum of the amounts calculated pursuant to paragraph 2 (BPDE_t+BPDADJ_t) ; and

(ii) the additional costs payments made to the relevant DN operators under paragraph 5 ($ACPS_t + ACPW_t$) from shippers in the relevant formula year to which such payments relate.

7. The licensee shall by 31 July in each formula year submit to the Authority a statement setting out:

- (i) the bulk price differential payments made pursuant to paragraph 3; and
- (ii) the additional costs payments made pursuant to paragraph 5 in the previous formula year.

8. In this condition:

“bulk price differential” means the volume of LPG conveyed to consumers connected to each relevant independent system in the relevant formula year, multiplied by the difference between the reasonable estimate (made by the licensee) of

- (i) the actual delivered price of LPG supplied to consumers connected to the relevant independent system; and
- (ii) the average price of gas consisting principally of methane supplied to large industrial customers in Great Britain.

“DN operator” has the meaning given in Standard Special Condition A3 (Definitions and Interpretation).

“independent system” has the meaning given to the term “independent system” in Standard Special Condition A3 (Definitions and Interpretation), save that, for the purposes of this condition only, such independent systems shall only include those independent systems through which the gas conveyed to consumers consists wholly or mainly of LPG or LNG.

“LPG” means a mix of hydrocarbon gases including propane and butane in accordance with BS EN 589:2004.

“LNG” has the meaning given to the term “LNG” in Special Condition C1 (Amendments to Standard Special Conditions relating to LNG)

“relevant” for the purposes of this condition only, means in relation to any

shipper” premises connected to an independent system, a gas shipper which has made arrangements with the DN operator which operates the LDZ in which that independent system is situated under which LPG or LNG is to be transported to consumers.

“RPI_t ” has the meaning given in paragraph 3(a)(ii) of Special Condition C8B (NTS transportation owner activity revenue restriction).