



*Promoting choice and
value for all customers*

Ian Davis
Director, Grain LNG National Grid
House Warwick Technology Park
Gallows Hill
Warwick
CV34 6DA

Direct Dial: 020 7901 7412
Email: sonia.brown@ofgem.gov.uk

2nd August 2006

Dear Ian,

Use it or Lose it Arrangements at the Isle of Grain LNG importation facility

I am writing to you following the introduction earlier this week of the new arrangements for third parties to gain access to the Grain LNG (GLNG) terminal in the event that the joint shipper (BP/Sonatrach) are not utilising the capacity that they acquired through the open season process – so called use it or lose it arrangements. As you will be aware this concludes a lengthy discussion that we have been having and it seems an appropriate time to set out our position on these issues.

We are obviously writing to you as the holder of an exemption order under section 19C(5) of the Gas Act 1986 (the "exemption order"). As you are aware, the exemption order was granted on the basis that GLNG would put in place effective anti-hoarding measures which would allow spare capacity to be made available to the market ("Use it or Lose it Arrangements", referred to as ULoI arrangements). The ultimate objective of such measures is to ensure that spare capacity can be obtained in a transparent market-based manner by third parties so as to prevent hoarding of the capacity.

Late last year we started a dialogue with you and the Joint Shipper following concern that the Grain facility was not being fully utilised despite price differentials indicating that the terminal should have been fully used. These discussions have helpfully included two seminars where third parties have been able to set out their views on these issues.

We are pleased to see that the joint shipper has now developed revised Use it or Lose it Arrangements with documentation made available on LNG Grain Agency's website on 31st July 2006. We welcome the development of these revised arrangements and believe they represent a significant improvement over the arrangements that were in place in November last year.

Whilst we consider these arrangements a significant improvement, you will be aware that concerns have been raised (including from third parties) that the changes that have been introduced are not sufficient. These concerns can be summarised as follows:

- **Reserve price.** The auction rules specify that a reserve price would be included in the auction and that any offer below the reserve price may be rejected. We believe that it would be helpful if the joint shipper would release further information concerning the reserve price. In particular it would be helpful to understand a) whether the reserve price will be announced to parties taking part to the auction or not; and b) of what the methodology used for setting the reserve price is likely to be. This is an area where we may wish to comment on further once the full arrangements become available.
- **The auction timetable and timing of gate closure.** The auction is to be announced 10 days prior to the slot being available and bids will need to be received 3 days later. You will be aware that the issue of the appropriate notice period has been discussed at length and that there are differing views on this matter ranging from parties requiring several months notice to the position of the joint shipper.

As you would expect, Ofgem will be monitoring closely the effectiveness of these revised Use it or Lose it Arrangements. In the event that any third parties express concerns regarding the operation of these arrangements, we will invite submissions from market participants to get their views on which slots could have been utilised and how had different UIoLI arrangements been in place.

In the event that we receive substantiated complaints from market participants that the new arrangements are not effective or if we develop any concerns regarding the use of the facility, we would consider moving straight to reviewing the exemption order for GLNG.

As we have previously discussed, we are not going to formally approve the new arrangements to be put in place at the Isle of Grain facility. Rather, it is for GLNG to ensure and demonstrate that there is a transparent mechanism that allows spare capacity to be made available to the market so as to maximise the use of the facility. It is important to recognise that this is an ongoing requirement and that revisions may be necessary in response to changes in the global LNG market, as more LNG import facilities are developed in GB, or in the light of any other development or evidence that the arrangements you have put in place are not being effective. In short, it is incumbent upon you to ensure compliance with the terms of the exemption order, and more specifically the effectiveness of UIoLI arrangements.

Should you wish to discuss the content of this letter further, please do not hesitate to contact me or alternatively, Sophie Trémolet on 020 7901 7311 or Helen Connolly on 020 7901 7267.

Yours sincerely



Sonia Brown
Director, Wholesale Markets

Cc:

David M Thomas, BP Gas Marketing Limited,
Mohand Bouadi, Sonatrach