



National Grid Grain LNG Ltd
Grain 3 Expansion
Application for Exemption from Section
19D of the Gas Act 1986 (as amended)

June 2006

Version 1.0

Contents

<i>Executive Summary</i>	<i>i</i>
1. <i>Introduction</i>	1
<i> Security of Supply Benefits</i>	2
<i> Economic Benefits</i>	5
2. <i>Project Outline</i>	7
3. <i>Capacity Sale Process</i>	9
<i> Open Season Process</i>	9
4. <i>Contractual Arrangements</i>	11
5. <i>Requirement for Exemption from the provisions of Section 19D of the Gas Act</i>	12
6. <i>Criteria required to be satisfied for granting of Exemption from the application of Section 19D of the Gas Act</i>	14
7. <i>GLNG assessment that criteria for granting of exemption from Section 19D of the Gas Act have been met</i>	16
<i>Condition a) The facility (or as the case may be) the significant increase in its capacity will promote security of supply</i>	16
<i>Condition b) The level of risk is such that the investment to construct the facility or (as the case may be) to modify the facility to provide for a significant increase in its capacity would not be or would not have been made without the exemption</i>	18
<i>Condition c) The facility is to be owned by a person other than the Gas Transporter who operates or will operate the pipeline system connected to or to be connected to the facility</i>	20
<i>Legal Separation</i>	20
<i>Licence Obligations and National Grid Gas plc Undertaking</i>	21

<i>Financial separation.....</i>	22
<i>Condition d) Charges will be levied on users of the facility or (as the case may be) the increase in its capacity</i>	22
<i>Condition e) The exemption will not be detrimental to competition, the operation of an economically efficient gas market or the efficient functioning of the pipeline system connected or to be connected to the facility</i>	23
<i>The investment enhances competition in gas supply</i>	23
<i>Competition assessment.....</i>	25
<i>Economically Efficient Gas Market.....</i>	26
<i>Efficient functioning of the connected pipeline system.....</i>	26
<i>Information Provision</i>	26
<i>Anti-Hoarding / Use It Or Lose It.....</i>	27
<i>Condition f) The Commission of the European Communities is or will be content with the exemption.....</i>	31
8. Duration of exemption from Section 19D of the Gas Act	33
9. Conclusions.....	35
Appendices	38
<i>Appendix 1 - GLNG Location Map</i>	39
<i>Appendix 2 - Isle of Grain Proposed Site.....</i>	40
<i>Appendix 3 - Consents Required</i>	41
<i>Appendix 4 - Request for Proposals Documentation ("RFP")</i>	42
<i>Appendix 5 - Contract Structure</i>	59
<i>Appendix 6 - Summary of Proposed Access Terms</i>	60
<i>Appendix 7 - Competition Study by Frontier Economics</i>	63

<i>Appendix 8 – Comparison of Grain (post Grain 3) with Centrica's Rough facility</i>	64
<i>Appendix 9 - Licence Conditions / Gas Act Obligations</i>	68

Executive Summary

The Second EU Gas Directive¹ was transposed into UK law on 26th August 2004 with the coming into force of the Gas ("Third Party Access") Regulations 2004 (SI 2004/2043). This amended the Gas Act 1986 ("The Gas Act") to transpose into UK law the provisions of the Second EU Gas Directive.

Under Section 19C(2) of the Gas Act, National Grid Grain LNG Limited ("GLNG"), a subsidiary of National Grid plc, is requesting an exemption from the application of Section 19D of the Gas Act ("exemption") to the proposed expansion ("Grain 3 Expansion") at its existing LNG importation facility on the Isle of Grain. The Grain 3 Expansion will provide an additional throughput of up to around 5mtpa of LNG (which equates to an additional deliverability capability of 210GWh/day), which is in addition to the c10mtpa of total capacity that will be available from October 2008 following completion of the second phase of the development of the Isle of Grain facility ("Grain 2"). The exemption requested in this application is required to ensure that the Grain 3 expansion project proceeds.

A process to offer the Grain 3 Expansion capacity to the market through a third "open season" process commenced in December 2005 and an engineering design study has recently been completed. Throughput agreements and construction contracts will only be entered into and construction of the Grain 3 Expansion will only commence if an exemption is granted by Ofgem and ratified by the European Commission.

In order for the Grain 3 Expansion to proceed, the exemption requested should apply to the full capacity of c5mtpa for a duration of up to 20 years or until October 2029 at the latest. Furthermore, and in order to allow consistency of approach for individual Shipper contracts as well as between Shippers, the exemption requested should be consistent with that granted in respect of the first two phases of the development of the Isle of Grain facility ("Grain 1 & 2").

In 2004, the UK became a net importer of gas and the latest estimates published by National Grid Gas ("NGG") indicate an import dependency of some 46% by the end of the decade, rising to around 80% by 2014/15. Further expansion of the LNG importation terminal on the Isle of Grain site will therefore provide additional capability to help address this forecast import requirement. It also provides shippers with a greater diversity of options for delivering gas to the UK and potentially, through the interconnectors, to Europe in response to market signals. Without this additional capacity, the UK could become more reliant on piped

¹ Directive 2003/55/EC of the European Parliament and the Council

gas/storage capability from mainland Europe. Exposure to European imports alone can raise issues for UK gas prices and security of supply, as demonstrated in November 2005 when imports through the I(UK) interconnector did not fully reflect market signals as expected. Other problems were also experienced last winter with piping gas across Europe when certain supplies were reduced and consequently gas intended for other markets was not delivered². The expansion project therefore also brings further benefits to UK consumers as well as for those in Europe generally in relation to diversity and security of supply at a time when indigenous supplies of gas are in rapid decline.

The Grain 3 Expansion project is set against a backdrop of an already advanced and highly competitive gas supply market in the UK and the introduction of additional supply capability will provide further access to worldwide, predominantly Atlantic basin LNG sources, thereby enhancing competition in the market and benefiting end consumers; particularly given the decline of indigenous supplies. Indeed, GLNG has made every effort to ensure that the disposal of throughput capacity at the terminal is done in a manner consistent with the requirements of an open market and, to the extent relevant, a Regulated Third Party Access ("RTPA") regime i.e. via a transparent and non-discriminatory open season process whereby the price paid for capacity is based on market valuations. This, coupled with appropriate information provision and anti-hoarding measures, serves to further ensure that there will be no detrimental impact on competition such as would give rise to a need for RTPA.

A small number of market participants argued at the start of winter 2005/06 that the existing GLNG facility should be more heavily regulated so as to ensure maximum utilisation and help keep gas prices low. GLNG is of the opinion that increasing regulation would result in an access regime that is in all material respects the same as that presently in place and, would not therefore, result in any greater use of the facility. Conversely, the ability for the regulator to require changes to the access regime at its sole discretion, through the requirement to approve tariffs or tariff methodologies ex-ante, would create uncertainty over access for potential facility users and uncertainty over future revenues for the project developers. Consequently, GLNG believes that further regulation would actually inhibit investment in infrastructure in the UK as LNG supplies would instead seek more attractive markets within the North Atlantic LNG market place with less third party access ("TPA") regulation such as in the US. This, in turn, would lead to reduced market access for market participants and therefore loss of security of supply and competition benefits that additional infrastructure could bring to UK consumers (as well as, potentially consumers in Europe).

² Platts LNG Daily - 3 January 2006

At present, and with regard to the existing importation capacity at Grain, the contractual arrangements relating to the annual capacity charge paid by GLNG's customers ensure that the primary capacity holder is fully incentivised to utilise the capacity for their own supplies, acquire cargoes from third parties or trade capacity via secondary mechanisms. This process ensures gas will flow when market prices dictates and shipping logistics allow. Ultimately, if the capacity is not used via one of these mechanisms, effective UIOLI arrangements would provide a final offering of access to capacity not expected to be used. This is consistent with the current situation of exempt LNG terminals and certain interconnector capacity in the UK. When the Grain 3 Expansion is commissioned there will be several exempt facilities which are all likely to be operating similar secondary trading and UIOLI mechanisms. As a result, there will be a significant number of trading counterparties for secondary users to negotiate with and fewer concerns over UIOLI access arrangements. Notwithstanding this, and in view of recent concerns regarding the UIOLI arrangements at Grain, the existing shipper, BP/Sonatrach is currently taking steps to implement arrangements which go well beyond a traditional UIOLI mechanism in order to ensure secondary capacity is made available after all normal trading mechanisms have failed.

Exemption from RTPA does provide significant benefits to:

- the terminal operator, by providing long term certainty in respect of the revenues it needs to fund the long payback period for the very significant investment associated with large infrastructure developments of this nature; and
- to the LNG shippers, by providing certainty in respect of the long-term access to importation facilities required to underpin their major upstream investments.

Consequently, GLNG is of the view that the requirement to seek regular approvals of access methodologies ex-ante could generate material risk for the project developer with the result that, in the absence of an exemption, Grain 3 would not proceed. This will have the effect that there will be less capacity available to Shippers wishing to bring gas into the UK market. Under the regime of an exemption, Grain 3 would still be subject to regulatory oversight as it is expected that the effectiveness of any anti-hoarding measures would be kept under review by the Authority. Through-putters' behaviour would also be closely monitored to ensure no abuse of any dominant position could arise, and then only if such a position of dominance emerges.

The presence of ineffective anti-hoarding mechanisms or any circumstances in which a through-putter abuses any dominant position (if they hold such a position) would give rise to

a review and ultimately revocation of any exemption awarded in respect of the Grain 3 Expansion.

GLNG believes incentives at Grain are appropriately placed on the primary holder of capacity to either utilise the capacity, including filling the capacity through acquisition of cargoes from third parties³ or to sell unused capacity to the secondary market. The UIOLI arrangements in the form being implemented by BP/Sonatrach act as an effective fallback mechanism for selling unused capacity when normal bilateral negotiations have failed. In addition, GLNG also believes secondary trading and capacity release is better facilitated by LNG shipper(s) who have control over ship and stock movements and are active in the gas and LNG shipping markets rather than a terminal owner who has no such knowledge or experience. This way, less value is destroyed through loss of flexibility for the primary capacity holder but a further level of effective anti-hoarding mechanism is introduced.

It is also important to note that following completion of Grain 2 there will be 4 shippers active at Grain, and it is anticipated that all will have similar anti-hoarding measures in place. By 2010, it is also expected that the LNG market will have developed in terms of greater upstream capacity and an increase in LNG ships. Consequently, there will be greater access to secondary capacity and significantly less chance of any party being able, even if they had any commercial incentive to do so, to engage in any meaningful 'hoarding' of capacity, since alternative secondary capacity would be available from other Shippers. Despite this, GLNG intends to 'go further' under the Grain 3 Expansion to ensure that any new shippers have express obligations to introduce a secondary trading mechanism similar to that being introduced by BP/Sonatrach or by any other Shipper that has RTPA-exempt LNG importation capacity secured via long-term contracts by the time Grain 3 enters commercial operations in 2010. This, coupled with the competitive nature of the UK gas market, the open and non-discriminatory auction of primary capacity and lack of essential infrastructure requirements means that there should be no regulatory concerns with Grain 3 Expansion capacity being exempt from RTPA requirements. Furthermore, granting of such an exemption would also seem consistent with those facilities that are either existing or under construction and which have already been granted exemption.

As noted above, there have already been enhancements in information provision since the first phase of the terminal became operational in July 2005 with the publication by GLNG of aggregate flows of LNG (i.e. daily GWh/day throughput data) into the NTS & LDZ system entry points. For the Grain 3 Expansion (and in addition to that information already being

³ For example, as per the 140,000m³ cargo that Gazprom Marketing & Trading bought from Gaz de France and delivered to BP on 11 April 2006 at the Grain terminal – Platt's 11 April 2006

provided) GLNG also intends to publish aggregate stock level information (provided there remain more than 3 shippers utilising the terminal at any given time, in accordance with agreements emanating from the Ofgem and DTI information disclosure work in relation to single/few user terminals).

In summary, given the already competitive state of the UK market, GLNG's market based approach is likely to be an improvement over any RTPA-based solution on the basis that the latter is designed to address market failures and reliance by third parties on essential infrastructure that are not features of the UK market. For the above reasons, GLNG believes that an exemption from the RTPA provisions set out in Section 19D of the Gas Act should not give rise to any concern for regulatory authorities. Further, an exemption of sufficient duration to cover both the long 'break-even' period and the primary contracts underpinning the investment is essential to ensure the Isle of Grain expansion project proceeds. Without an exemption, the income assurances required to make the project viable would not be sufficient when taking into account the significant risks associated with the project and National Grid's view of the risk-reward balance. As a result, without the grant of an exemption, the project will not proceed.

Following this Executive Summary is GLNG's formal exemption application, the format of which follows that adopted in the exemption submission for Grain 1 & 2. In this document, GLNG demonstrates that it satisfies all criteria set out in Section 19C of the Gas Act for an exemption from the RTPA provisions of Section 19D of the Gas Act to be granted. The document also demonstrates how GLNG and the expansion project satisfy the additional complimentary tests set by Ofgem and the DTI that concern the requirement to:

- offer capacity initially to the market;
- implement effective secondary trading & anti-hoarding mechanisms (i.e. use it or lose it arrangements - "UIOLI"); and
- provide information to the market.

Assessment against criteria:

- a) The Grain 3 expansion will significantly enhance the security of gas supply of both the UK and mainland Europe from 2010/11 onwards through the introduction of additional LNG importation capacity. Delivery of additional LNG importation capability provides shippers with the option to deliver gas to the UK in response to market signals. Without this additional capacity, the UK will become ever more reliant on

piped gas/storage capability from mainland Europe which has in the past not always been seen to respond to market signals⁴. Even if this issue is resolved in the future, the expansion project still brings benefits in relation to supply and competition through the potential introduction of new shippers and new sources of LNG;

- b) GLNG demonstrates that the risk of the expansion project from the investors' perspective (in relation to both upstream and downstream infrastructure) is such that it will not proceed without an exemption;
- c) GLNG is both financially and legally separate from both NGG and Southern Gas Networks, the operators of the pipeline systems to which the Isle of Grain LNG importation terminal is connected;
- d) As a separate company, GLNG's sole source of revenue is from charges levied on users of its infrastructure;
- e) An independent study carried out by Frontier Economics of the impact on competition along all levels of the supply chain concludes that the investment is not detrimental to competition and that competition may be further enhanced by the introduction of a new entrant(s); and
- f) On the basis that it satisfies the above tests, GLNG is of the opinion that the Commission of the European Communities will be content with the exemption.

In respect of the additional tests:

- 1) Access to the GLNG expansion capacity has been offered to all market players via a transparent and non-discriminatory open season process whereby the price paid for capacity is based on market valuations;
- 2) GLNG has proposed appropriate anti-hoarding measures and publication of relevant information to enable the market to make considered decisions with regard to secondary trading; and
- 3) GLNG will comply with Section 19DA of the Gas Act in relation to provision of information to the Authority and is supportive of publication of information to the market.

⁴ http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/14456_winterexperiencefs.pdf

In summary, this application demonstrates that the project to further expand the Isle of Grain LNG importation facility satisfies all the criteria set out in Section 19C of the Gas Act for the grant of an exemption from the RTPA obligations of Section 19D, as well as the complementary tests set by Ofgem and the DTI. The granting of an exemption should not give rise to any concern for the regulatory authorities and will enable the GLNG facility to deliver further significant benefits to the UK and EU in relation to security of supply and competition in gas supply.

1. Introduction

- 1.1. National Grid Grain LNG Ltd ("GLNG"), a wholly owned subsidiary of National Grid plc, was set up in June 2002 to convert the then existing peak shaving storage assets at Grain into the UK's first modern LNG importation terminal ("Grain 1").
- 1.2. Final commissioning of the terminal and commencement of commercial operations took place in July 2005. The initial throughput capability of the terminal is 3.3 million tonnes of LNG per annum (mtpa), c.4.5 billion cubic metres (bcm). This initial capacity was sold to BP/Sonatrach under a 20-year agreement.
- 1.3. A second tranche of capacity (6.5mtpa) was sold in March 2005 to Centrica, Gaz de France and Sonatrach and a contract signed with CB&I John Brown to construct three new 190,000m³ storage tanks and associated process plant. This construction work is currently ongoing and the new capacity is due to be available in time for winter 2008/09 ("Grain 2").
- 1.4. GLNG, which is a separate, independent legal entity from NGG (the regulated operator of the UK's National Transmission System (NTS)), is considering further developing the Grain LNG importation and regasification terminal. This third phase of the Grain facility development ("Grain 3") will provide the opportunity to expand the terminal by an additional throughput capability of up to around 5mtpa and will enable further supplies of liquefied natural gas (LNG) to be attracted to the UK from LNG producing nations around the world.
- 1.5. GLNG believes the Grain facility offers significant benefits over other LNG sites in the UK since the expansion capacity only represents incremental investment on top of the existing importation facility⁵. Not only should this mean a smaller overall environmental impact (compared to the construction of a new facility on a new site), but additional expansion will also facilitate more efficient utilisation of ancillary plant and equipment such as the existing cryogenic pipeline (and potentially, more efficient utilisation of the existing storage tanks). The site also benefits from readily accessible additional deep water berthing. Furthermore, the Medway and Thames estuaries are already accustomed to this type of shipping and the facility also benefits from an existing connection to the UK NTS that will be further reinforced as a result of the successful Grain 2 expansion⁶. Finally, while benefiting from a relatively remote position in terms

⁵ Despite the expansion only representing incremental investment, the project still bears significant financial risk for GLNG

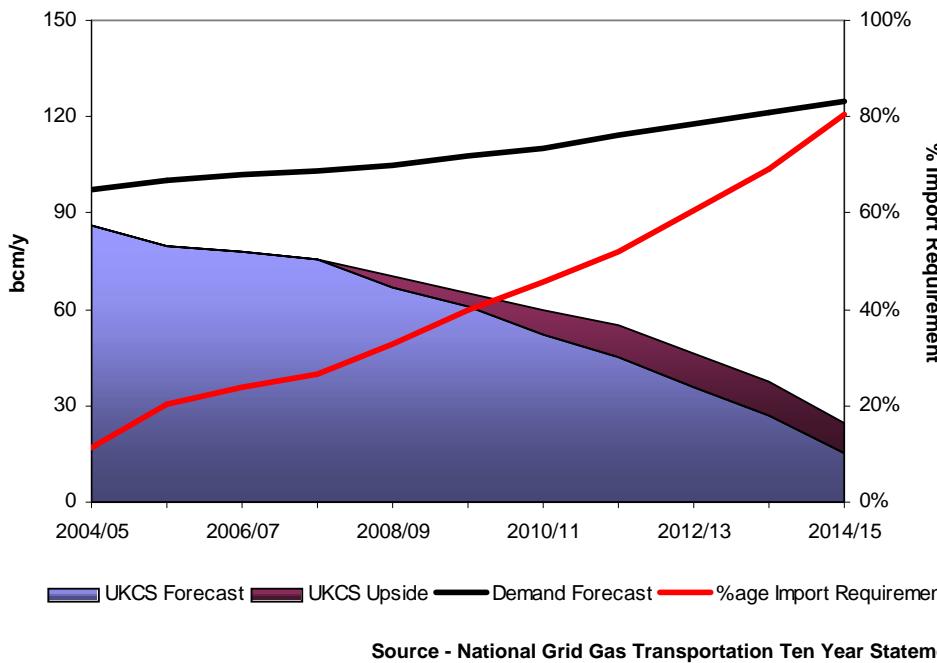
⁶ The UK NTS may also require incremental expansion to enable Phase 3 shippers to fully utilise any new capacity

of local population, the Grain site, being located just some 20 miles east of greater London is close to the most significant area of UK demand (Appendix 1 refers).

- 1.6. As stated above, the Grain 3 development will provide the opportunity to expand the Grain terminal by an additional throughput capability of up to 5mtpa (assuming 'base-load' operation). This will be achieved through the construction of a second jetty, new regasification capacity and increased storage capacity. Although GLNG will build, own and operate the expanded importation terminal, the scheduling of gas deliveries to and from the facility will be under the control of holders of capacity rights at the facility (as per Grain 1 & 2). Access to the primary expansion capacity at this facility will be on a long-term contractual basis. These long-term capacity rights have and will be offered through a non-discriminatory "open season" process and will allow successful shippers the opportunity to import gas into the UK from sources other than the United Kingdom Continental Shelf (UKCS) or transported via existing Interconnectors from or through mainland Europe. This third phase of construction work would give Shippers the option to increase the total throughput capability of Grain to a total of around 15mtpa (21bcm).

Security of Supply Benefits

- 1.7. According to NGG's ten year statement, over the past decade, UK gas demand has grown at an average of just over 5.5% per annum. This has largely been driven by the increasing NTS demand from the power generation sector and through additional exports to Ireland and Continental Europe. Although these demand growth rates have slowed over the last few years (due to increasing gas prices and the relative weakness of the energy intensive manufacturing sector in the UK), given the current decline in UK gas production, it is clear that significant UK gas imports will be required in the future.
- 1.8. In 2004, the UK became a net importer of gas, and the latest NGG estimates indicate an import dependency of some 46% by the end of the decade, rising to around 80% by 2014/15 (see Figure 1 overleaf).
- 1.9. It was against such background that GLNG converted the existing peak shave LNG storage facility at the Isle of Grain into a LNG importation terminal and undertook to further develop the site through the first expansion of the facility.

Figure 1 – NGG Demand Forecasts & Import Requirement

1.10. In addition to Grain, and against the same background, other UK importation facilities have also commenced development over the past few years including two LNG terminals at Milford Haven and the new pipelines between the UK and Belgium and the UK and Norway. Despite these new projects however, the decline in UKCS production and the associated forecast increased gas demand has meant that the gas price, as indicated by the forward price curve, has not fallen as predicted⁷, suggesting a further requirement for additional imported gas supplies. Consequently, market conditions appear to indicate an increasing need for new gas supply sources as well as investment in infrastructure projects to meet both the annual base load and the peak loads expected in the winter months.

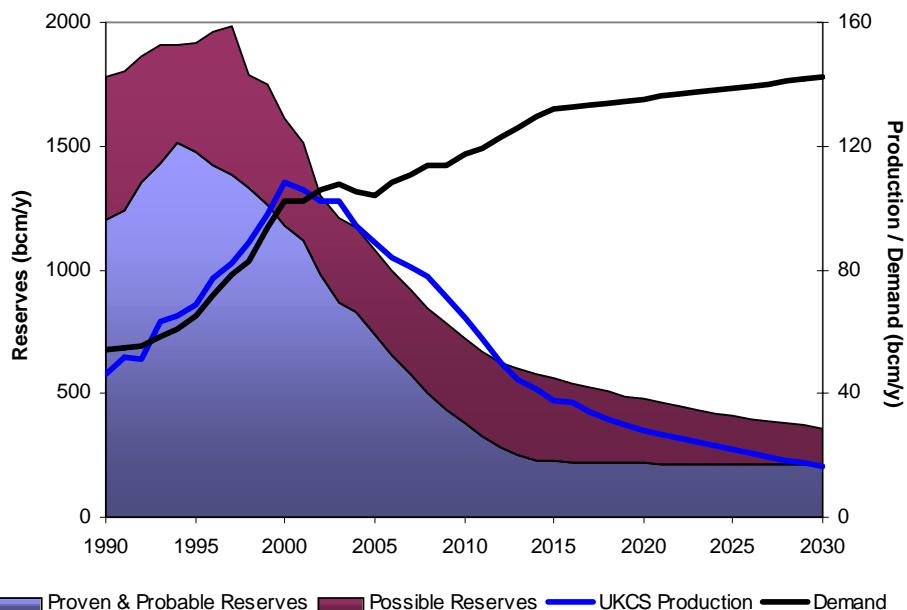
1.11. Figure 2 below shows DTI reported reserves since 1990 and a central scenario for remaining UKCS reserves and production. This figure demonstrates the rapid increase in imports that is required in the UK in order to meet demand from UK consumers.

1.12. A number of substitutes for imported LNG supplies obviously exist, including the supply of gas via pipelines from continental Europe. Presently, one such pipeline exists, being the I(UK) interconnector between Bacton in the UK and Zeebrugge in Belgium. In addition, two further pipelines are currently under construction these being the BBL

⁷ Argus European Natural Gas – May 2006

interconnector between Bacton and Balgzand in Holland and the Langeled pipeline between Easington in the UK and Sleipner in Norway. Both of these developments are due to come on line for next winter (2006/7). Further pipelines may also be constructed between the UK and Europe or indeed the current capacity of the existing interconnectors may be further increased⁸. Nevertheless, in the medium term, the provision of gas supplies through these interconnectors still limit UK gas supplies to gas sourced from one of three main gas producing countries being the Netherlands, Norway and Russia (although in the longer term gas may be supplied via pipeline from Iran through Turkey and from Algeria via France, Spain & Italy).

Figure 2 – Remaining Reserves and Production Projections



Source - National Grid Gas Transportation Ten Year Statement 2005

1.13. However, in terms of most piped supplies, the UK will be at the end of a very long European network and over-reliance on a number of interconnectors (supplied by a very few producing countries) would lead to increasingly lower levels of supply security as UKCS reserves decline. This would have a knock on effect on security of supply levels in continental Europe as the UK would be reliant on Europe for baseload and swing provision, potentially including access to storage. Furthermore, over reliance on any single medium in this case through piped gas from Europe also dilutes the benefits

⁸ BBL confirmed in February 2006 of their plans to double the capacity of the BBL line to 44MMcmd from March 2007

that diversity of supply brings acutely demonstrated by events in the Ukraine and Georgia last winter in relation to piped supplies from Russia.

1.14. In addition to the above, the unplanned and prolonged outage of Centrica's storage facility at Rough through much of last winter, has also demonstrated the importance of having a sufficient "supply margin" in ensuring security of supply to the UK gas market.

1.15. Consequently, increasing the UK's LNG importation capacity will provide increased security of supply for the UK through provision of both a high baseload and some limited swing capability from a diverse range of non-European sources. Equally, LNG imported into the UK at Grain or any other UK terminal may flow to other European markets via these interconnectors providing an enhancement to European security and diversity of supply.

1.16. In conclusion, the development of additional importation capacity at Grain that:

- has the ability to operate at a high baseload with limited upward and some downward flexibility; and
- has the ability to treat LNG from a wide range of sources to ensure appropriate gas quality criteria are met,

will therefore provide a major contribution to security of supply through providing further diversity of supply to the UK.

Economic Benefits

1.17. LNG importation facilities benefit the internal market by providing access to global LNG supplies and production. Furthermore, LNG potentially provides a substitute for other non-UKCS gas supplies thereby enhancing price competition in the UK. Expansion of the GLNG terminal will further shift the supply curve to the benefit of consumers compared to the situation if the GLNG expansion project were not to go ahead.

1.18. Alternative supplies to the UK could be sourced by import of LNG through terminals in mainland Europe for onward export to the UK via interconnectors, or from gas stored in European storage facilities and transported through pipes to the UK gas market in winter when prices appear attractive; albeit, potentially only once the risk of European shortages late in the winter have abated. However, with only a small number of interconnectors this would be less secure for the UK than a diverse range of primary supplies and is also predicated on the assumption that there is sufficient capacity

available in the transportation systems in continental Europe to deliver the required gas to the interconnector.

1.19. A further alternative is demand side action (e.g. interruption), although this has implications in respect of the general promotion of the use of gas, which is considered to be less damaging to the environment than other fossil fuel sources as well as productivity and competitiveness of UK industry.

1.20. In respect of each of these substitutes the market is free to choose whichever combination of supply sources it believes is economic and efficient to use, and on those terms it determines to be acceptable. Accordingly, the market will allow for such factors as regulatory uncertainty in developing valuations for each of the substitutes available to it. This includes the impact arising out of environmental legislation and initiatives to reduce pollution in line with the Kyoto protocol, to which all EU member states have committed to take the lead in tackling climate change⁹. The UK Government's commitment to meet the Kyoto targets as set out in the February 2003 Energy White Paper¹⁰ was a key motivation behind the Energy Act 2004. The impact of the resulting legislation is expected to increase, in the short term, at a time when declining UK supplies further contribute demand for gas to a growing supply/demand gap. Without sufficient gas supplies being made available to the UK wholesale market to fill this gap the ability of the UK to meet its environmental targets could be in jeopardy.

1.21. The project to expand the Isle of Grain LNG importation capacity is set to provide an already competitive UK market with access to further gas supplies, so that the market can decide how best to meet its competing obligations. This project is by no means the only project that could provide access to additional supplies¹¹ to the UK market, though paragraph 1.5 above outlines a number of benefits that the Grain facility offers over other LNG sites. The level of activity in the provision of additional facilities is evidence that the UK market is responding to signals to develop competitive supplies that the market values accordingly, although in many cases only when subject to an acceptable regulatory environment. This means that, in respect of the UK, no market failure or essential facility issues arise that need to be addressed via an imposed RTPA regime.

⁹ Energy Bill [HL] 53/3, 27 November 2003, page 4.

¹⁰ Dti Energy White Paper – “Our energy future – creating a low carbon economy”, February 2003

¹¹ Examples of other projects include, inter alia, the potential on-shore LNG importation projects at Canvey Island, Teesside and Anglesey, the Stag Energy off-shore LNG importation terminal and salt cavern gas store project and the development of various other interconnector and gas-storage projects.

2. Project Outline

- 2.1. The third phase of the Grain facility development will provide the opportunity to expand the terminal by an additional 50% to around 15mtpa. Actual expansion will be subject to certain approvals and what is actually built will depend on market requirements. To achieve anticipated market requirements however, necessitates the significant investment in new infrastructure at the facility including, inter alia, the following:
- a) The construction of a second jetty capable of accommodating LNG tankers of between 125,000m³ and 265,000m³ plus ancillary equipment;
 - b) The construction of some 490m of new cryogenic pipeline (including expansion/contraction loops) to link the unloading line from the new jetty into the existing cryogenic pipeline. The new section of pipeline will be laid above ground but will be enclosed on each side by 2m high concrete security walls plus high security fencing (in the same way as the existing pipeline is protected);
 - c) The installation of up to 6 new submerged combustion vaporisers;
 - d) The installation of additional boil-off gas compressors (to accommodate the higher boil-off rates during ship unloading);
 - e) The construction of up to 2 new 190,000m³ total containment tanks and associated delivery capability;
 - f) The installation of new recondenser capacity; and
 - g) The construction of new nitrogen ballasting plant and power capacity.
- 2.2. A small amount of capital investment has been made in relation to enabling works; (i.e. essential works to facilitate Grain 3 expansion which will be undertaken as part of phase 2 construction). However, while this is in addition to the development costs sunk by GLNG, it only amounts to less than 1% of the anticipated investment. No further Grain 3 capital investment will be made until an exemption is granted and planning permission has been received.
- 2.3. The diagram in appendix 2 shows a plan view of the Grain LNG Importation Terminal site.

- 2.4. Numerous regulatory, safety and environmental consents are required to ensure the project remains on schedule to ensure commercial operations commence by winter 2010/11 (see appendix 3).
- 2.5. Application for planning consent for the new jetty, the additional total containment tank(s) and the other plant and equipment which needs to be installed to increase the throughput of the Grain facility to 15mtpa (20bcm) is to be submitted by the end of Q2 2006.

3. Capacity Sale Process

Open Season Process

- 3.1. The key objective of the Grain 3 capacity sale process is to secure sufficient financial commitment from users to underwrite the project investment. As with previous 'phases', the Grain 3 capacity sale consists of a transparent 3-stage 'Open Season' process i.e.
 - a) Stage 1 – Request For Proposals ("RFP"): basically a request for Shippers' expressions of interest and corresponding indicative bids. This stage of the third open season has attracted strong interest, similar to previous open seasons;
 - b) Stage 2 – Invitation to Submit Firm Proposals ("ISFP"): selected parties are requested to submit firm binding bids;
 - c) Stage 3 – Award of Contract: At this stage, GLNG will have the option to accept proposals or to negotiate.

Appendix 4 contains the RFP documentation and confidential appendix CA1 summarises the current status of the open season process.

- 3.2. Notwithstanding the above, in order to proceed to the firm bid stage, GLNG has advised potential customers to assume that exemption from the RTPA requirements of Section 19D of the amended Gas Act 1986 is granted by the relevant authorities (Ofgem and the European Commission). Furthermore, GLNG has also advised potential customers that should such exemption not be forthcoming, bids would effectively be void and the bidding process in respect of Grain 3 would be terminated.
- 3.3. In relation to the above, and as with both the conversion and initial expansion phases, other assumptions have been made by GLNG, most notably that the significant development, construction, operational and regulatory risks would be rewarded through appropriate returns and that bidding parties would require secure long-term access to capacity in order to underwrite their very significant upstream investment. With regard to the above, GLNG believes that the latter condition needs to be satisfied in order that the open season process is able to produce the returns required for the former condition to be fulfilled.
- 3.4. If shippers were presented with shorter term access or disrupted access then they would factor in this increased risk, devaluing their use of the terminal (and therefore the price they would expect to pay for capacity) to a level which would generate insufficient

project returns for GLNG to financially justify the continuance of the Grain 3 Expansion. It is for these reasons that GLNG will only proceed with the Grain 3 expansion in the event that an exemption from Section 19D of the Gas Act is forthcoming.

- 3.5. Alternatively, shippers would look for more certain means of accessing the downstream markets to underpin their significant upstream investment, potentially removing the opportunity for UK and other European markets to access these additional supplies.
- 3.6. An attractive market for Shippers is the US where no requirement for RTPA exists for new LNG importation terminals following the "Hackberry Decision" in 2002, which recognised that the regime in force at that time, requiring RTPA, was preventing investment in infrastructure. Following the removal of the requirement for RTPA, more than 40 applications have been made for LNG importation infrastructure in the US and LNG imports will potentially exceed 100mtpa by 2025¹². On top of this, new terminals have also been proposed in Canada, the Bahamas and Mexico; several aimed at feeding the US market. Given the reduced potential for new piped supplies, the US may provide less market (gas price) risk than the UK. The East Coast terminals have already attracted current and future supplies from Trinidad, Nigeria, Angola, Egypt, Algeria and the Middle East. This large market in the Atlantic basin, coupled with strong growth in LNG demand in India, Korea and China, will attract supplies from the Middle East and may leave fewer supply options for a European market were this to be rendered less attractive by virtue of unnecessary regulation.
- 3.7. In summary, in order for the Grain 3 expansion project to proceed, GLNG and the bidding shippers require an exemption from the RTPA requirements of the Gas Act, and continue to make the assumption, that an exemption from RTPA arrangements will be granted. However, the decisions to enter into contracts with LNG Shippers and to commence construction of additional capacity will be subject to obtaining the formal exemption. GLNG envisages entering into such contracts in Q4 2006 to allow the additional LNG supplies to be sought for importation capacity to be available for winter 2010/11. Construction is targeted to commence as soon as possible after this date, dependent upon receipt of the required planning consent.

¹² US Government Energy Information Administration – Annual Energy Outlook 2004.

4. Contractual Arrangements

- 4.1. The main agreements that underpin the Isle of Grain importation facility are shown schematically in appendix 5. A summary is provided below with further detail provided in appendix 6.
- 4.2. The contracts between GLNG and its existing customers are as follows (these will also be adopted for Grain 3):
 - a) Specific Terms Agreement (STA): these are the terms specific to individual users and cover such items as contract term, the level of the shipper's firm rights to berthing slots, capacity and deliverability, the annual charge to be levied and, where applicable, commissioning arrangements; and
 - b) General Terms and Conditions (GTCs): these are the standard terms applicable to any user of the facility covering for example, ship unloading, delivery to National Grid Gas's system and credit and billing arrangements. They are multi-user agreements that facilitate secondary trading and sub-letting of capacity, deliverability, berthing slots and LNG within the facility. These features are designed to help mitigate the exclusivity over the use of initial capacity when the incumbent shipper is not using this capacity.
- 4.3. In accordance with developments since Grain 1 commenced commercial operations, GLNG intends to include an additional obligation in the STA of any new contract for expansion capacity: a requirement on Grain 3 Shipper(s) to adopt transparent secondary trading/anti hoarding mechanisms similar to those proposed by BP/Sonatrach. Further details of these proposals are provided at <http://www.lngga.com/main.html>.
- 4.4. Entry into an STA and GTCs with Grain 3 expansion shipper(s) will be conditional on GLNG being granted planning permission and an exemption from the requirements of Section 19D of the Gas Act for all of the Grain 3 Expansion Capacity for a suitable duration.

5. Requirement for Exemption from the provisions of Section 19D of the Gas Act

- 5.1. The Second Gas Directive was transposed into UK law with the coming into force of the Gas (Third Party Access) Regulations 2004 on 26th August 2004. The Directive requires Member States to ensure that access to new LNG importation terminals and other infrastructure is via a RTPA regime based on tariffs, or tariff methodologies, approved ex ante by the relevant regulatory authorities. These RTPA requirements are set out in Section 19D of the Gas Act.
- 5.2. The Second Gas Directive also allows regulatory authorities to exempt new infrastructure from RTPA provisions. This includes modifications to existing infrastructure that enable the development of new sources of gas supply. The exemption regime introduced into UK law to enact this requirement is set out in Section 19C of the Gas Act.
- 5.3. The exact form of an RTPA regime is difficult to determine precisely as many forms exist but, GLNG assumes that the RTPA provisions as set out in section 19D of the Gas Act suggest a requirement to published tariffs or tariff methodologies, approved ex-ante by the Authority with such terms of access being non-discriminatory. In all likelihood, for LNG importation this would require an auction of long term capacity rights with effective anti-hoarding measures. Similar to the RTPA approach used to provide entry access to NGG's NTS pipeline system.
- 5.4. In respect of GLNG's exemption application for the conversion and initial expansion phases, Ofgem / DTI set out in their initial views document¹³ that the European Commission had clarified that:

"Where there is a non-discriminatory and transparent auction procedure approved by the Regulator in conformity with this Directive [Directive 2003/54] the Commission confirms that this represents regulated third party access within the meaning of the Directive".

Consequently, the non-discriminatory and open auction process for securing primary capacity rights developed by GLNG reflects the attributes of an RTPA regime and should not give rise to any regulatory concerns at either the national or European level.

¹³ LNG facilities and interconnectors: EU legislation and regulatory regime, Ofgem/Dti initial views, June 2003 para 5.7

5.5. Whilst GLNG specifically designed a process that is both open in nature and non-discriminatory, it would not have been appropriate for it to speculate on, or seek to build in the possible further requirements of an RTPA regime that might be imposed in the absence of the market based solution that was adopted. Full application of a detailed RTPA regime would prejudice the overall viability of the Grain 3 expansion project because:

- a) Without the ability to socialise the investment costs, the variability in revenues from the potential periodic changes to the access regime required by the Authority, or reduction in tariffs over time would result in shorter term access rights that would introduce sufficient uncertainty in the revenues that would be derivable from the Grain 3 Expansion to make the project not viable. Consequently, this would be unacceptable to National Grid given the substantial risks involved in the project. The risk of building capacity speculatively for shorter term contracts is considered too high given the competing projects and the level of investment required. The potential returns and an assessment of the risks are provided in confidential appendix CA2;
- b) Similarly, the additional risk associated with the revenue if it were subject to periodic regulatory review would raise the threshold return required by National Grid and that would make the project not viable;
- c) Conversely, under an RTPA regime where long term access was less certain, shippers would wish to reduce, not increase, their bid price resulting in failure of the process to elicit bids of a level consistent with the operator's view of the risk-reward balance; and
- d) Inconsistency in contracts between phases will necessitate the operation of multiple commercial regimes leading to operational difficulties and increased operating costs. This would be compounded if an importing shipper(s) was subject to different regimes by virtue of contracting for capacity in different phases making the terminal less attractive and, depending on the degree of inconsistency, making the project not viable.

5.6. An exemption is sought for 100% of the project's anticipated expansion capacity of c5 mtpa, irrespective of the timing of when the capacity is sold.

5.7. In summary, GLNG is formally seeking an exemption under section 19C(2) of the Gas Act from section 19D of the Gas Act. Obtaining an exemption will confirm the acceptability of the open season capacity sales process and increase the likelihood of

GLNG being able to enter into long-term contracts (which has already been accepted under the phase 1 & 2 exemptions) essential to underpin the investment in Grain 3. The duration of the required exemption is covered in section 8.

6. Criteria required to be satisfied for granting of Exemption from the application of Section 19D of the Gas Act

6.1. Section 19C of the Gas Act provides for an exemption to be granted from Section 19D of the Gas Act provided 6 criteria are met:

- a) The facility (or as the case may be) the significant increase in its capacity will promote security of supply;
- b) The level of risk is such that the investment to construct the facility (or as the case may be) to modify the facility to provide for a significant increase in its capacity would not be or would not have been made without the exemption;
- c) The facility is or is to be owned by a person other than the gas transporter who operates or will operate the pipeline system connected to or to be connected to the facility;
- d) Charges will be levied on users of the facility (or as the case may be) the increase in its capacity;
- e) The exemption will not be detrimental to competition, the operation of an economically efficient gas market or the efficient functioning of the pipeline system connected to or to be connected to the facility ; and
- f) The Commission of the European Communities is or will be content with the exemption.

6.2. In addition, and in their final conclusions document¹⁴ relating to the conversion and initial expansion phases of development at Grain, Ofgem and DTI published additional tests that they believe need to be satisfied to demonstrate sufficient competition and effective access to facilities in an exempt or RTPA regime:

- a) A requirement initially to offer capacity to the market;
- b) Effective secondary trading and anti-hoarding mechanisms; and

¹⁴ "LNG facilities and interconnectors: EU legislation and regulatory regime, DTI/Ofgem final views, November 2003

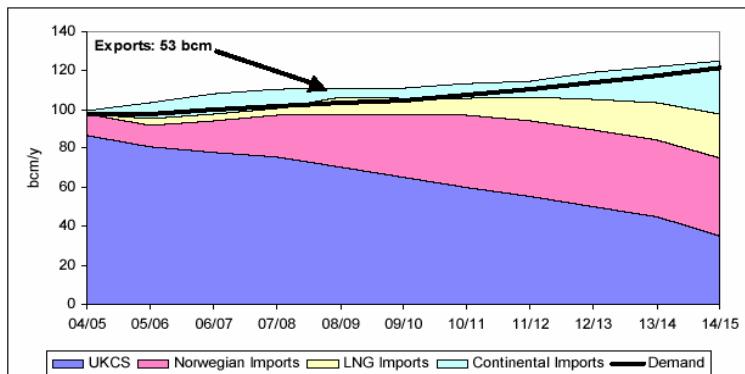
- c) Information provision.
- 6.3. In the following sections the Grain 3 expansion project is assessed against each of these criteria and tests to demonstrate to Ofgem, the DTI and the European Commission that an exemption from Section 19D of the Gas Act is appropriate for the Grain 3 expansion of the Isle of Grain LNG Importation Facility.

7. GLNG assessment that criteria for granting of exemption from Section 19D of the Gas Act have been met

Condition a) The facility (or as the case may be) the significant increase in its capacity will promote security of supply

- 7.1. Figure 1 above is taken from National Grid's Ten Year Statement and highlights the supply shortfall and level of imports required by the UK to achieve a supply-demand balance in the years through to 2014/15. As can be seen, the extent of new imports required is considerable, increasing to some 80% over this time period. Even taking into account existing imports from Vesterled, I(UK) and Grain, the shortfall in supplies, evident since 2004 (when the UK became a net importer of gas for the first time), increases dramatically through to the end of the decade and beyond.
- 7.2. Figure 3 below demonstrates how the Grain conversion phase has helped fill the supply gap since the facility was commissioned in July 2005. Since then, some 16TWh of energy has been delivered to the UK through the LNG importation facility through to the end of March 2006. Although this is slightly less than originally expected due, in part, to the impact of hurricanes Rita and Katrina on the US gas price in the early part of the winter which led more shipments of LNG going to that market, it is some 13 times the maximum export which could have been achieved over the winter period had the facility remained as a peak shave storage facility or indeed some 98 times the actual average export from the Grain peak shave facility over the period 2002 to 2005.

Figure 3 – Supply forecasts including GLNG importation (Global LNG Scenario)



Source - National Grid Gas Transportation Ten Year Statement 2004

- 7.3. Figure 3 also demonstrates how new interconnector projects, other LNG importation projects (including the Grain initial expansion phase that comes on line in 2008/9) and additional imports from Norway all contribute capacity which, provided sufficient gas is brought to market via these routes, will satisfy the gas supply shortfall¹⁵ to meet market demand. Nevertheless, recent events have clearly demonstrated the importance of both 'supply diversity' and 'over capacity' in ensuring security of supply.
- 7.4. Events in the Ukraine and Georgia have demonstrated the potential 'fallout' of not having supply diversity in relation to piped supplies from Russia (or any of the other small number of countries supplying piped gas to Europe i.e. predominantly Norway and Algeria). Furthermore, and despite a number of projects under construction to increase interconnection capacity with mainland Europe, recent experience has shown that having the capacity is not the same as guaranteeing the supply of additional gas. Imports through pipelines are only likely to occur should the gas supplies and supply security of other European utilities, not at the extremity of the European network, already be secured (regardless of price differential).
- 7.5. The unplanned outage of Centrica's storage facility at Rough through much of last winter has also demonstrated the importance of having a 'sufficient supply margin' and diversity of supply to ensure security of supply to the UK gas market.
- 7.6. Increasing the ability to deliver additional non-indigenous sources of supply into the UK therefore enhances UK security of supply which, is of particular importance given

¹⁵ In addition to the projects assumed in the background of Figure 3, there are a number of other potential new importation projects under consideration (both interconnectors and LNG terminals). If all of these potential projects were to come on line, it would result in over-capacity for the forecast time horizon. In such event, LNG and interconnector supplies would adjust in order to meet market demand (either through moderated imports or increased exports). Nevertheless, it is expected that

indigenous supplies through existing UK entry points are on the decline and their reliability may be expected to decline as investment reduces and assets are 'wound down'.

- 7.7. Further expansion of the GLNG importation facility that has the ability to operate at high baseloads with some limited upward and downward flexibility that has, through the installation of gas blending plant, the ability to accept LNG from a variety of sources, means that this will be a significant contributing factor in enhancing UK security of supply position over the whole year.
- 7.8. Finally, it is also noteworthy that the construction of a second jetty and additional storage/re-gasification plant also improves the resilience of the Isle of Grain facility as a whole, which in itself has security of supply benefits e.g. one of the strategic advantages of adding a second jetty is that in the event one jetty is unable to operate, unloading can still take place using the other jetty (albeit that some LNG cargoes might be subjected to certain delays).

Condition b) The level of risk is such that the investment to construct the facility or (as the case may be) to modify the facility to provide for a significant increase in its capacity would not be or would not have been made without the exemption

- 7.9. The European Commission Interpretative note¹⁶ identifies a risky investment as one where at least "*the investment concerned is a sunk cost in that the asset concerned cannot be recovered and re-used for another purpose other than its original one*". In the event either planning consent or exemption from the RTPA requirements were not forthcoming (or not forthcoming in a timely manner), the open season process would be terminated and all investment incurred by GLNG to date in respect of the Grain 3 expansion phase would be sunk costs that fit the description set out above.
- 7.10. The Grain 3 expansion project is a major, capital intensive project requiring investment significantly in excess of the threshold investment level illustrated in the European Commission Interpretative note of approximately Euros 210 million for the UK (see confidential appendix CA2). To date, GLNG has invested in excess of Euros 4.3 million for feasibility analysis, initial market testing and in engineering design studies in respect of the Grain 3 development. An additional amount (less than 1% of expected total capex) has been committed for 'enabling' works (design changes required to the Grain

¹⁶ 'supply' will adjust in line with market requirements thereby resulting in a supply/demand match similar to that shown in Figure 3 above.

¹⁶ Interpretive note relating to directives 2003/54-55 and regulation 1228/03 30.1.2004

2 development necessary in order to allow the Grain 3 expansion to proceed). Notwithstanding this, investment beyond the above levels will not be committed by GLNG until the open season process has been successfully concluded, planning consent has been obtained and exemption from the RTPA requirements of Section 19D of the Gas Act has been granted. This is because the investment, if made, cannot be used for any other purpose than that of an LNG importation facility and is, as such, "sunk". Detailed financial information relating to the Grain 3 development is provided in confidential appendix CA2.

- 7.11. The investment should be viewed in the context of GLNG as an independent company, financially separate from National Grid plc. Costs are only underwritten by the parent company, National Grid. GLNG is taking significant counterparty, development, construction and operational risks, which are not underwritten by public investment and has no guaranteed rate of return or method of recovering income permitted by the national regulator. Consequently, the risks are notably higher than those relating to National Grid's regulated gas transportation, electricity transmission and gas distribution businesses. Confidential appendix CA2 includes an assessment of the relevant risks relating to the Grain 3 project.
- 7.12. In addition to the above, because of the current relative scarcity of LNG supply and the fact that other re-gas projects are being developed at the same time, GLNG is subject to commercial risks from other competing projects, including the various new piped gas and storage projects and other LNG importation terminals in the UK including Canvey Island, Teesside and Anglesey as well as the many other LNG projects all around Europe. Furthermore, as seen above, there is also the possibility of potential LNG supplies being attracted to other markets outside the European Commission because of more favourable market and regulatory conditions.
- 7.13. As with the conversion and initial expansion phases of the Grain facility, the Grain 3 expansion phase has a long pay back period and the absence of an exemption, or an exemption of shorter duration than that requested, would lead to insufficient certainty over returns. Similarly a lower tariff, or tariff subject to regulatory uncertainty, would be insufficient to ensure that the expansion project remains within the acceptable risk profile for its investors.
- 7.14. As highlighted in our previous application (in relation to Grain 1 and 2), the risk attached to LNG importation projects should consider the risks facing LNG shippers who need to make significant investment in upstream plant. Given the cost and lead

time in building upstream facilities (production, liquefaction and shipping) the least risk approach is to develop excess re-gas capacity (i.e. so as to avoid there being importation constraints). While the LNG market provides some opportunity to place excess capacity or to work around constraints, it may not be straightforward to find an alternative destination for individual cargoes. To the extent the buy/sell price risk associated with the LNG market is large, investment will be discouraged and prices will rise unless there is capacity certainty at a terminal. These risks can be mitigated by guaranteed long-term access to the downstream market. In respect of the conversion and initial expansion phases at Grain, contracts of 20 years or more were placed with BP/Sonatrach and Centrica, Gaz de France and Sonatrach. This length of contract is typical in the US market where there is no RTPA requirement, for example:

- Sabine Pass LNG has entered into 20-year Terminal Use Agreements (TUA's) with Total LNG USA Inc and Chevron USA Inc for capacity at their LNG receiving terminal on the Louisiana Gulf Coast¹⁷; and
- Freeport LNG Development has entered 20-year and 17-year TUA's respectively with The Dow Chemical Company and MC Global Gas Corporation for capacity at their LNG receiving terminal in Quintana, Texas¹⁸.

7.15. Without an exemption, long term access cannot be guaranteed, especially given regulatory practice in the UK transportation network sector which has, until recent years, been based exclusively on short-term capacity rights. Consequently, while the upstream investment may go ahead, it will only be attracted to the UK or Europe if bidders can secure access at reduced tariffs commensurate with their greater risk and uncertainty. This in turn may be insufficient in relation to the risk-reward appetite of the investing parties for projects such as the GLNG terminal to proceed.

7.16. In summary, because of the risks highlighted above, the Grain 3 project will only proceed to the construction phase should exemption from Section 19D of the Gas Act be granted.

Condition c) The facility is to be owned by a person other than the Gas Transporter who operates or will operate the pipeline system connected to or to be connected to the facility

Legal Separation

¹⁷ http://www.cheniere.com/LNG/LNG_sabine_pass.shtml

¹⁸ <http://www.freeportlng.com>

7.17. The owner and operator of both the existing importation terminal infrastructure and all expansion phases is National Grid Grain LNG Ltd (“GLNG”), company number 4463679. GLNG is a wholly owned subsidiary of National Grid plc.

7.18. The System Operator of the system in which this infrastructure operates is National Grid Gas plc (“NGG”), company number 02006000, a wholly owned subsidiary of National Grid plc. NGG and GLNG are separate, independent subsidiaries of National Grid plc. Grain is also connected to the local distribution system owned by Southern Gas Networks plc (“SGN”).

7.19. GLNG is therefore a separate and independent legal entity from NGG and interacts with NGG and SGN in the same way as any other third party. Further, GLNG is not affiliated with any gas marketing entity utilising the system.

Licence Obligations and National Grid Gas plc Undertaking

7.20. Further to the above legal separation, NGG is subject to the following Licence Conditions and Gas Act obligations to ensure that no unfair commercial advantage is conferred on GLNG (full text in appendix 8):

- a) Standard Special Condition A6 - Conduct of Transportation Business: this condition requires NGG to conduct its transportation business in the manner best calculated to secure that no related undertaking, such as GLNG, obtains any unfair commercial advantage.
- b) Standard Special Condition A35 - Prohibition of Cross-Subsidies: this condition requires NGG to procure that the transportation business shall not give or receive any cross subsidy from any affiliates, such as GLNG.
- c) Standard Special Condition A39 – Indebtedness: this condition requires that NGG shall not incur any “indebtedness” or enter into any guarantee otherwise than on an arms length basis, under normal commercial terms and for permitted purposes. (“Indebtedness” - Means all liabilities now or hereafter due, owing or incurred, whether actual or contingent, whether solely or jointly with any other person and whether as principal or surety, together with any interest accruing thereon and all costs, charges, penalties and expenses incurred in connection therewith.)
- d) Section 9 (1A) of the Gas Act Powers and Duties of Gas Transporters: states that a gas transporter is obliged to facilitate competition in the supply of gas.

- e) Section 9 (2) of the Gas Act: Powers and Duties of Gas Transporters: this states that it is the duty of the gas transporter to avoid any undue preference or undue discrimination in connection to its pipeline system or in terms on which it undertakes the conveyance of gas through its system.
- 7.21. Additionally National Grid plc, as ultimate controller of NGG for the purposes of its gas transporter licences, undertakes the following to ensure NGG compliance with obligations under Standard Special Condition A26 ("Provision of Information to the Authority") and Condition 45 (Undertaking from Ultimate Controller") of each of its licences:
- a) *"We will give to you, and will procure that any person (including, without limitation, a corporate body) which is a subsidiary of, or is controlled by us (other than you and your subsidiaries) will give to you all such information as may be necessary to enable you to comply fully with the obligation imposed on you in paragraph 1 of Standard Special Condition A26", and*
 - b) *"We will refrain from any action, and will procure that any person (including, without limitation, a corporate body) which is a subsidiary of, or is controlled by us (other than you and your subsidiaries) will refrain from any action which would then be likely to cause you to breach any of your obligations under the Gas Act 1986 or the Licence."*
- 7.22. All contracts between NGG, GLNG, the primary capacity holders of the conversion and first Grain expansion phase and other relevant parties have been negotiated on an arms length basis on normal commercial terms consistent with NGG's Licence and the National Grid plc Group Undertaking.
- Financial separation***
- 7.23. GLNG has full financial separation from the other companies within the National Grid plc group including the requirement to file separate accounts at Companies House. The independently audited accounts for the period to March 2005 have been filed.
- Condition d) Charges will be levied on users of the facility or (as the case may be) the increase in its capacity***

- 7.24. GLNG's capital investment and ongoing costs are to be recovered through the sale of long term importation capacity rights. Importation shippers will be charged an annual charge for the use of GLNG capacity (these are detailed in the confidential appendix CA2). The consequence of this is that no part of the costs for the Grain 3 project will be

underwritten through regulated transmission charges. All costs will need to be covered by the receipt of revenues arising solely from the charges levied on the users of the facility.

Condition e) The exemption will not be detrimental to competition, the operation of an economically efficient gas market or the efficient functioning of the pipeline system connected or to be connected to the facility

The investment enhances competition in gas supply

- 7.25. The presence of an exemption for the further expansion of the LNG importation facility at Grain will enable the facility to be built and market operators in the UK to import additional gas from non-indigenous sources on a long-term basis. This development, against a backdrop of continuing and rapidly declining UKCS gas supplies, will provide enhanced gas on gas price competition thereby creating the potential to shift the supply curve to the benefit of consumers. In addition, further increasing the UK LNG importation capability also increases supply diversity that in turn will enhance security of both UK and EU gas supplies for the benefit of consumers. The level of these benefits may ultimately depend on how much LNG is delivered as a result of additional capacity being available. Given the cost, it is likely that any successful Grain 3 Shipper will deliver significant volumes over the term of the contracts.
- 7.26. Further benefits to UK competition may also arise at Isle of Grain through the potential introduction of further new entrants to the wholesale beach gas market and/or wholesale National Balancing Point ("NBP") market, though this will be dependent on the bids received by GLNG during the Grain 3 open season process and ultimately on the contracts placed between GLNG and Shippers in relation to the expansion capacity.
- 7.27. Granting an exemption from the requirement to provide RTPA at the Isle of Grain importation facility does not remove it from independent regulatory scrutiny in respect of Ofgem's wider duties. Under the Gas Act, Ofgem has a duty, amongst other things, to promote effective competition where it is appropriate and to secure a diverse and viable long-term energy supply in a manner best calculated to do so. To this extent, the additional tests required to be satisfied before an exemption is granted, provide the framework through which Ofgem can ensure it is able to comply with its obligations. Furthermore, any exemption will not remove the requirement for the commercial arrangements surrounding the terminal to comply with general competition law.

- 7.28. In this light it is important to indicate here the degree of similarity in the UK between an access regime operating under an exemption and one comprising RTPA. In particular, an RTPA regime might be expected to comprise of a requirement to offer non-discriminatory access to infrastructure on the basis of an appropriate ex-ante approved published tariff(s) or methodology where approved auctions are considered by the European Commission to be appropriate RTPA provisions. Consistent with operating under an exemption, through the non-discriminatory open season process GLNG has imported many of the aspects of an RTPA regime into its proposed access arrangements to provide comfort that the arrangements allow access to infrastructure on the basis of market prices and contract durations proposed by the bidders in the tender process.
- 7.29. Furthermore, the presence of pro-competitive general terms and conditions, ship vetting procedures and gas specification envelope information provided to market participants permits secondary trading and sub-letting of capacity that, when coupled with Ofgem's duty to promote competition, should provide ample protection against the possibility of market abuses.
- 7.30. The key difference appears to be that under an exempted regime GLNG will be able to access secure and stable revenues over the long period necessary to underpin the investment required in the facility, and upstream shippers will have the long term capacity certainty necessary to underpin their investment.
- 7.31. In the UK the absence of any issues associated with access to essential facilities should also mean that granting an exemption to GLNG should not be a cause for concern. The UK does not have any supply diversity obligations that would require compulsory access to LNG importation capacity. Gas supplies are free to choose where to enter the UK with prices for using infrastructure to transport gas to those entry points determined in a competitive marketplace.
- 7.32. In short, given the highly competitive nature of the UK market, GLNG's market-based approach is likely to be an improvement over an RTPA solution that is designed to address market failures that are not a feature of the UK market. Indeed, applying this test in the same way for all Member States means that projects in the UK will face a higher hurdle because of the highly competitive nature of the UK gas market.
- 7.33. Notwithstanding the pro-competitive arrangements outlined above, GLNG provides the competition assessment set out below.

Competition assessment

- 7.34. In accordance with DTI / Ofgem's previous guidance¹⁹ GLNG commissioned Frontier Economics to undertake an independent assessment to determine the impact of the Grain expansion project on competition in relevant markets²⁰.

Frontier Economics' overall conclusion is that

"In our view, there is no relevant market in which Grain 3 (with RTPA exemption) would have a materially adverse competitive impact even if, in each market, the party with the highest market share in each market were to acquire exclusive rights to Grain 3. Consequently, we conclude that exemption from RTPA would not be detrimental to competition".

- 7.35. In addition to the above, and given the size of the Grain facility (with Grain 3 in place), it is possible that certain comparisons to Centrica's storage facility at Rough might be made. This is subject to a series of undertakings Centrica has given to the Secretary of State concerning, amongst others, access provisions. In view of this, GLNG has undertaken a comparison of the two facilities, the results of which demonstrates that perhaps not surprisingly, GLNG's facility at the Isle of Grain is actually more comparable with other beach terminals rather than a long range storage facility. In carrying out this analysis, GLNG has considered, inter alia, the economic analysis undertaken by the Competition Commission into its inquiry into Rough; (this analysis is provided in Appendix 8). Further, and in relation to this matter, the economic assessment carried out by Frontier Economics above also considers the different markets for gas flexibility and the seasonal storage market in particular. This is because these markets were deemed to be relevant by the Competition Commission in its Rough inquiry. Again, the results of this economic analysis demonstrate no competition concerns exist.

¹⁹ LNG facilities and interconnectors: EU legislation and regulatory regime – DTI/Ofgem Final views", November 2003 para 5.15

²⁰ The full competition assessment performed by Frontier Economics is available in Appendix 6

Economically Efficient Gas Market

- 7.36. The additional importation capacity brought into the UK as a result of an exemption for the Grain 3 expansion phase has been demonstrated by independent analysis, to enhance competition in gas supply and not to be to the detriment of competition along any other level of the supply chain. Given the absence of any detrimental impact on competition it is difficult to envisage how the investments at the Isle of Grain could be considered to have any further possible detrimental impact on the effective functioning of the internal gas market. Therefore, GLNG must conclude that the investment at the Isle of Grain is unlikely to be to the detriment of competition or the effective functioning of the internal gas market.
- 7.37. Whilst the competition assessment sets worst case boundaries by making assumptions about which companies might hold capacity, it is important to remember that capacity will be allocated to successful bidders via the open season process. Commentary on the more likely outcome is provided in appendix CA2. In addition there will be appropriate mechanisms in place to prevent hoarding as set out below. Both of these factors are likely to enhance the likelihood of the gas market continuing to remain economically efficient.

Efficient functioning of the connected pipeline system

- 7.38. GLNG is already party to NGG's standard terms and conditions in relation to connection to, gas quality and flow of gas into the NTS(i.e. the Network Entry Agreements). Similarly, any new shippers bringing gas into NGG's network through the Isle of Grain facility will do so in accordance with the Uniform Network Code. Similarly, GLNG also has a Network Entry Agreement ("NEA") with Southern Gas Networks Ltd a subsidiary of Scotia Gas Networks the owner of the distribution network to which Grain connects which covers similar requirements.
- 7.39. In summary, the Isle of Grain LNG importation terminal will be of positive benefit to competition and hence the operation of an economically efficient gas market and arrangements have been made to ensure its compatibility with the pipeline systems to which it is connected.

Information Provision

- 7.40. In accordance with Section 19DA of the Gas Act GLNG will provide appropriate information to Ofgem as required on an ex-ante and ex-post basis, including for

example, data on nominated and actual capacity utilisation, daily send-out, outage planning and availability of secondary capacity.

7.41. GLNG also has a statutory obligation to publish its annual accounts and those for 2004/5 have been filed at Companies House.

7.42. Since the terminal commenced operations in July 2005, information has been improved through GLNG's publication of aggregate flows from the facility (i.e. NTS plus LDZ flows in aggregate) on its website.

7.43. In relation to other information to the market, GLNG is supportive of the principle of equivalence but is mindful of the characteristics of single/few user terminals and the sensitivity to its customer(s) of publishing such information. Such sensitive information would include the price of primary capacity, publication of which would also need to be considered in light of its potential detrimental impact on possible subsequent open season processes.

7.44. While the contractual arrangements do not inhibit release of information to the regulatory authorities, they do contain standard confidentiality clauses that would restrict flow of commercially sensitive information to the marketplace. However, GLNG would anticipate gaining consent from users of the facility to release information where this was consistent with the agreements reached between Ofgem, DTI, and the industry. Following completion of the Grain 3 development, when there are likely to be more than three primary capacity holders at Grain, such data provision may include the publication of aggregate information in relation to Grain operations e.g. GLNG anticipates that it will publish daily aggregate stock levels.

7.45. In summary, information on historical usage will be made available to the regulator (in accordance with Section 19DA of the Gas Act) and where consistent with confidentiality arrangements it will also be made available publicly. Appropriate *ex-ante* information will also be made available to the regulator.

Anti-Hoarding / Use It Or Lose It

7.46. One aspect of regulation in the UK, applicable to both regulated and exempt regimes, relates to the implementation of appropriate 'anti hoarding' mechanisms so as to maximise the potential utilisation of facilities such as LNG importation terminals. This is commonly referred to as the Use-It-Or-Lose-It provisions, "UIOLI".

- 7.47. GLNG recognises that such 'anti-hoarding' measures need to reflect the three capacity elements of an importation terminal namely berthing slots, space and deliverability. As with the existing terminal, GLNG will provide appropriate information to the regulatory authorities in respect of the Grain 3 capacity, such that monitoring of potential hoarding will be facilitated.
- 7.48. At present, and with regard to the existing importation capacity at Grain, the contractual arrangements relating to the annual capacity charge paid by GLNG's customers ensures that the primary capacity holder is fully incentivised to firstly utilise the capacity for their own supplies or secondly, to acquire cargoes from third parties in order to utilise allocated capacity. There have been several examples of this latter practice taking place this winter i.e. examples of acquisitions by the primary Shipper of 3rd party cargoes which have been delivered to the terminal (e.g. the 140,000m³ cargo that Gazprom Marketing and Trading bought from Gaz de France and delivered to BP on 11 April 2006 at the Grain terminal)²¹.
- 7.49. Further, given LNG shipping logistics (which means reasonable notice is preferable), and the need for the primary shipper to make space available in the terminal for any third party cargoes, this is the primary route through which 3rd parties who wish to bring LNG to the UK will gain access to the terminal when BP/Sonatrach are not intending to use the facility at full throughput (i.e. secondary capacity is obtained through early bilateral negotiations with primary holders of capacity). Only when such negotiations fail will UIOLI come into play as a clearing mechanism. The shorter notice period associated with this should not necessarily be a problem as any genuine Shipper with a cargo should have already been in discussion with the primary capacity holder.
- 7.50. Notwithstanding the above, and in the event capacity is not intended to be utilised by the primary capacity holder through either of the above two mechanisms (i.e. for its own-use or through acquisition of 3rd party cargoes), the primary capacity holder is fully incentivised to offer 'spare' capacity to the secondary market. To facilitate this, the Grain 1 primary capacity holder currently publishes details of any spare capacity available for use by third parties on a public website. In the event third parties are subsequently interested in obtaining such secondary capacity, they then need to contact the primary capacity holder to discuss their requirements and the commercial terms for gaining such access. This way they will obtain notice of likely access well in advance of a particular berthing slot.

²¹ Platt's LN Daily - 11 April 2006

- 7.51. In addition to the above, GLNG has also developed a 'bulletin board' on which parties may express interest in buying or selling capacity at the terminal. Further information regarding the current UIOLI provisions at Grain can be found on the GLNG website at <http://www.nationalgrid.com/uk/GrainLNG/CommercialOperations/>
- 7.52. The above process provides a mechanism for secondary trading which recognises the need to protect the primary capacity holders' firm capacity rights (to the extent they are not hoarding) and exploits the primary users' greater knowledge of their intended use of the facility in relation to stock and ship movements as well as their greater knowledge of the LNG and shipping markets. Furthermore, such mechanisms also facilitate the most efficient stock management in a way that is most efficient to the market place as a whole.
- 7.53. Notwithstanding the above however, it is clear there are still some 'inconsistencies' between the arrangements sought by LNG importers at terminals and those which a small number of market players consider appropriate for such infrastructure. The former wish to ensure primary capacity rights remain sufficiently valuable and attractive whilst the latter wishes to ensure adequate anti-hoarding mechanisms are in place. As noted above, in order to address these concerns, but at the same time ensure primary capacity holders rights are not significantly eroded, and the terminal continues to remain an attractive destination for long-term LNG supplies when compared with markets where more 'light-handed' regulatory controls exist, GLNG together with the existing Grain Shipper, BP/Sonatrach, have already implemented changes to both the UIOLI and information provision arrangements at Grain. Furthermore, BP/Sonatrach are in the process of implementing an enhanced secondary trading mechanism that allows Shippers who do not own primary capacity at Grain to access the LNG importation facilities by entering a 'tolling arrangement' with BP/Sonatrach when capacity is not being used by the primary Shipper (details of their proposed modifications to the current UIOLI provisions are provided at <http://www.lngga.com/main.html>). This mechanism is considered to be superior to UIOLI given that the primary capacity holder utilises its send-out capacity and manages stock levels to allow a full cargo to be delivered.
- 7.54. In addition, as other LNG importation capacity enters the market, it is entirely conceivable that the secondary trading arrangements will further evolve (at both multi-user terminals such as Grain and own-use terminals such as the South Hook and Dragon projects). Furthermore, and so as to ensure new Grain Shippers also implement suitable UIOLI mechanisms, GLNG intends to amend the Specific Terms

Agreement (STA) of new Grain 3 Shipper(s) to include express provisions to develop and implement similar arrangements to those currently being developed by BP/Sonatrach (or by any other Shipper that has RTPA-exempt LNG importation capacity secured via long-term contracts by the time Grain 3 enters commercial operations in 2010). GLNG believes this to be a balanced approach which is consistent with those facilities that are either existing or under construction and which have already been granted exemption. We are not aware that other terminals have developed any alternative proposals and we anticipate that they are likely to adopt similar arrangements to those being put in place by GLNG and BP/Sonatrach. To go beyond the current approach would, in the opinion of GLNG, seem to be inconsistent with other LNG facilities and would also devalue the Grain 3 expansion capacity for Shippers' and LNG producers' to such extent that investment by GLNG would not proceed due to competition from other markets where regulation is more light-handed.

7.55. Furthermore, as additional importation facilities are developed, and more Shippers acquire primary capacity of their own, UIOLI should become less of an issue as there will be multiple ways to access the market through secondary trading without having to utilise a fallback UIOLI mechanism. In any event, the UIOLI arrangements currently being implemented by BP/Sonatrach will remain an adequate fallback method for selling unused capacity when normal bi-lateral negotiations have failed. As noted in paragraph 7.48 above, there is evidence to suggest there have been several examples of acquisitions by the primary Shipper of 3rd party cargoes which have been delivered to the terminal.

7.56. Finally, GLNG believes arguments suggesting Grain should implement similar UIOLI arrangements to those that exist at some other European LNG importation terminals e.g. the facilities at Fos sur Mer and Montoir de Bretagne in France and those owned by Fluxys in Belgium are inappropriate given Grain is an unregulated facility. The structure of the market arrangements that exist in, for example France and Belgium, is one of a single, vertically integrated, incumbent market player dominant in retail/supply and operating facilities on a relatively 'baseload' basis to meet a portfolio demand. LNG importation facilities in these countries benefit from a regulatory 'safety net' that effectively enables tariffs to be increased if revenues fall short of a permitted level to ensure adequate revenue is received by the owner/operator of the terminal. Consequently, any increase in tariff is easily passed through to end consumers in the form of higher prices given the dominance that incumbent vertically integrated players have in those markets. In such a situation early offering of unutilised capacity by the

primary capacity holder may be necessary to dilute the power of the incumbent dominant market player and maximise the opportunity for others to access capacity, in what, in continental Europe, are essential facilities. These are markets in which the European Commission has already raised concerns about there being insufficient competition²². Early offering of unused capacity by such an incumbent supplying a constant baseload should also be more straightforward given that diversions are likely to be infrequent.

7.57. This reasoning does not apply in the UK. The UK market has more attractive pricing at peak in the winter and therefore (at least in the near term) the terminal is less likely to see purely baseload throughput. Alternative choices of supply (i.e. piped) not controlled by a single dominant party means less price certainty for LNG Shippers and consequently greater value associated with being able to make decisions about where to send cargoes at short notice.

7.58. Furthermore, GLNG is non-regulated, is not owned or operated by a vertically integrated market player and competes against other importation projects. It does not benefit from a revenue safety net or the ability to increase imports to make sure of sufficient revenue. For phase 1, the non-vertically integrated nature of the terminal operator and limited space meant that control of ship movements and stock had to be passed to the shipper. This, along with an appropriate UIOLI mechanism which did not destroy the shipper's operational flexibility, meant that the product on offer was sufficiently attractive to fund the necessary investment. Even then, the returns were only just sufficient to make the project viable. The same holds true for Grain 3; loss of flexibility due to unnecessarily onerous UIOLI terms would devalue LNG importation facility's capacity to the extent that investment would not proceed.

7.59. Therefore, there is a need for a balance between primary rights of LNG importers and the desire of a small number of market players, which is appropriate for a market situation in the UK, to ensure the UK benefits from additional capacity becoming available. This is especially the case when new developments need to compete with the US market where there is no RTPA/UIOLI requirement but in which there is a similar competitive environment.

Condition f) The Commission of the European Communities is or will be content with the exemption

²² Despite the apparent 'open' UIOLI mechanisms at some of these facilities there appears little evidence to suggest any secondary trading activity has actually taken place to date.

7.60. For the reasons stipulated above GLNG believes it satisfies the criteria for exemption in relation to the Gas Act (the statute by which the Second Gas Directive has been transposed in UK law). However, it will ultimately be for the European Commission to determine whether this final condition is satisfied.

8. Duration of exemption from Section 19D of the Gas Act

- 8.1. GLNG requires exemption from Section D of the Gas Act in order to ensure the validity of the capacity sale process and the capacity and throughput agreements relating to the Grain 3 expansion. The duration sought reflects the long pay-back periods associated with the project, as set out in appendix CA2, and is required to ensure an appropriate return on investment. They are also required to ensure the downstream facility is sufficiently attractive to upstream suppliers, compared to those in other market places around the world, by providing certainty over long-term access for the duration of the contracts.
- 8.2. This is consistent with certain precedents of long duration exclusive access arrangements which the European Commission has previously accepted, for example, the 20 and 25 year exemptions granted in respect of the conversion and initial expansion phases at Grain, the 25 year exemptions granted in respect of the initial and expansion phases at South Hook at Milford Haven, the 20 year exemptions granted in respect of each of the two phases of the Dragon project at Milford Haven, the 20 year agreement with Fluxys with 3 different shippers and the 25 year access arrangements relating to the Viking Cable and I(UK) interconnector. This is also borne out by National Grid's experience in relation to other capital intensive infrastructure projects where long-term arrangements have been required to underpin investment, e.g. the Basslink interconnector linking Tasmania and the Australian mainland which was a 25 year agreement and the Isle of Man interconnector which was also a 25 year agreement. Ofgem and the DTI go further to state that they "*favour granting relatively long-term exemptions that are relatively speaking less likely to be reopened*"²³ where the criteria for exemption are met. For the reasons stated above in relation to payback period and appropriate return on investment, National Grid (as the party financing the project) would support this approach in relation to an exemption for the expansion of the GLNG terminal.
- 8.3. The European Commission is also supportive of long-term contracts where appropriate, recognising that they help to underpin security of gas supply as well as the competitive market in general. They state: "*long term contracts may also facilitate the diversification in the medium term of EU gas supply and help to bring new sources of gas to the market, hence enhancing supply side competition*".²⁴ As such, one of the

²³ LNG facilities and interconnectors: EU legislation and regulatory regime – DTI/Ofgem Final views, November 2003 para 5.51

²⁴ Proposal for a Directive of the European Parliament and the Council – concerning measures to safeguard security of natural gas supply – Explanatory memo.

European Commission's stated objectives is to develop a negotiation framework for long term contracts for security of supply benefit with Member States "guaranteeing" that a minimum proportion of their gas supplies from non-EU countries is based on long term import contracts.

- 8.4. The required exemption duration in respect of the Grain 3 expansion capacity is therefore a maximum of 20 years to October 2029.

9. Conclusions

- 9.1. The Second Gas Directive was transposed into UK law through the introduction of the Gas (Third Party Access) Regulations 2004 on 26th August 2004. Consequently, GLNG has requested an exemption from Section 19D of the Gas Act under Section 19C(2) of the Gas Act for the Grain 3 expansion capacity which increases the throughput of the facility by around 5mtpa (thereby increasing the total capacity to some 15mtpa).
- 9.2. The required duration of the exemption is a maximum of 20 years (or to October 2029 at the latest) to cover the full expansion capacity of circa 5mtpa (depending upon market requirements).
- 9.3. GLNG has shown that declining UKCS supplies and growing demand creates the conditions for LNG importation to play a vital role in enhancing the security of the nation's gas supplies by providing capacity to import additional non UKCS gas. This will enable gas to continue to contribute to achieving UK emissions targets whilst enhancing competition in gas supply to final consumers by shifting the potential supply curve in their favour.
- 9.4. GLNG has demonstrated that an exemption from RTPA obligations for its preferred duration creates the conditions necessary for appropriate project returns given its assessment of the risk-reward balance for a project with this risk profile. Without an exemption GLNG has identified that revenue and its assurance will not be satisfactory over the required duration to permit GLNG to accept ongoing project risk. As a result GLNG will not invest in this project unless an exemption for the stated duration is granted.
- 9.5. GLNG has demonstrated that it is both financially and legally separate from both NGG and SGN to whose networks the Isle of Grain terminal is connected. Furthermore, a variety of Licence conditions, group undertakings and primary legislation all exist so as to enforce the separate nature of GLNG business from the rest of National Grid and subsidiary businesses.
- 9.6. As a separate company GLNG has demonstrated that its only source of revenue will be from charges levied on users of its infrastructure. Furthermore, no mechanism exists that would enable the costs of GLNG to be underwritten by transportation charges levied by NGG.

9.7. As part of satisfying condition e) GLNG commissioned an independent study by Frontier Economics of the impact on competition along all levels of the supply chain as a result of the investment at the Isle of Grain. This study included the impact on competition with and without the expansion capacity. Frontier Economics concluded that no detriment to competition is expected as a result of the investment even if worst case assumptions about the results of the open season are made. GLNG also highlighted that it has entered into a variety of standard contracts with NGG and SGN that ensures efficient day to day communication between the facility and the appropriate operations teams; these contracts include the protocols necessary for the safe and effective cooperation of NGG and the Isle of Grain facility in the event of an emergency. Access arrangements to NGG's system would remain unchanged as a result of the any new Grain 3 expansion investment at GLNG. Given the absence of any detrimental impact on competition GLNG concludes that there is no conceivable scenario in which the investment at the Isle of Grain would be detrimental to the efficient functioning of the internal gas market or the pipeline system(s) to which the facility is connected.

9.8. GLNG believes it has demonstrated that it satisfies the criteria for exemption in relation to both the Gas Act and Second EU Gas Directive and the European Commission should therefore be content with the exemption.

9.9. In respect of the additional, complimentary, tests set by Ofgem and the DTI (concerning the requirement to offer initial capacity to the market; implement effective use it or lose it arrangements; and on information provision to the market), GLNG has provided detailed information on how it satisfies these tests:

- a) Access to GLNG Importation Capacity has and continues to be offered via a transparent and non-discriminatory open season process whereby the price paid for capacity is based on market valuations.
- b) GLNG, along with the primary capacity holders in relation to the existing capacity at Grain have implemented appropriate anti-hoarding measures and publication of relevant information to enable the market to make considered decisions with regard to secondary trading. This will be extended to Grain 3 expansion shippers.

9.10. GLNG is supportive of the publication of information to the Authority under Section 19A of the Gas Act and to the market provided the latter is in accordance with agreements emanating from the Ofgem and DTI information disclosure work in relation to single/few user terminals. As noted above, following completion of the Grain 3 development, when

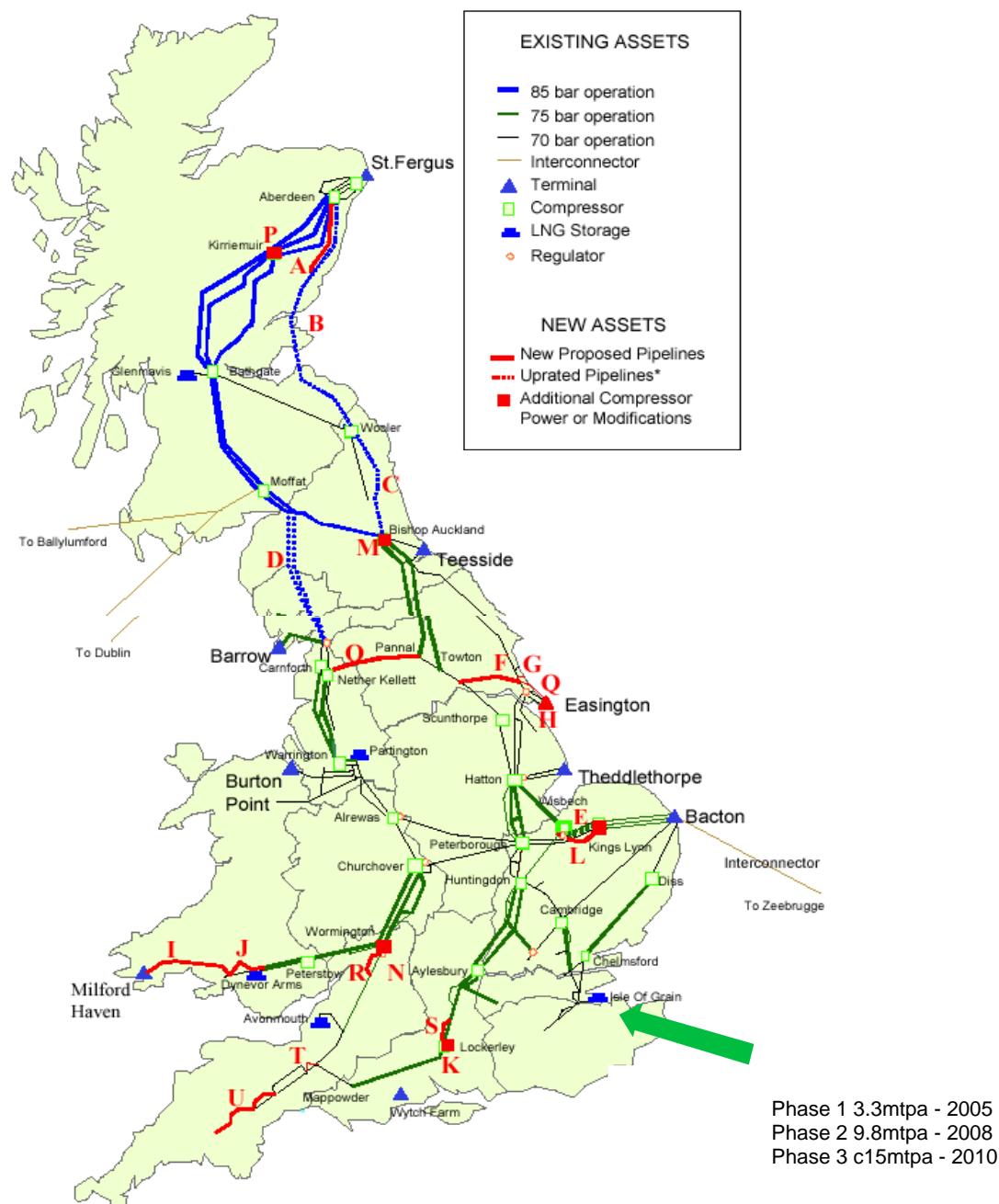
there is likely to be more than three primary capacity holders at Grain, such data provision may include publication of certain aggregate information in relation to Grain operations e.g. stock levels.

- 9.11. The existence of effective competition and likely ongoing prevalence of competition coupled with the long payback period associated with the project would meet Ofgem's conditions justifying the granting of exemptions of long duration. The duration to be set to cover both the payback period and the term of contracts, which underpin the investment.
- 9.12. GLNG believes that the project will significantly enhance both UK and European supply security from 2010/11 onwards.

Appendices

1. GLNG Location Map
2. The Isle of Grain Proposed Site
3. Consents required
4. Request for Proposals Documentation ("RFP")
5. Contract Structure
6. Summary of Proposed Access Terms
7. Competition Study by Frontier Economics
8. Comparison of Grain (post Grain 3) with Centrica's Rough facility
9. Licence / Gas Act Obligations

Appendix 1 - GLNG Location Map



Appendix 2 - Isle of Grain Proposed Site



Appendix 3 - Consents Required

Gas Act

- Exemption from RTPA provisions of Section 19D of the Gas Act, permitted under Section 19C(2) of the Gas Act

Safety Case / COMAH

- Amendment to Isle of Grain COMAH case / COMAH notification
- Amendment to Isle of Grain hazardous substances consent

Planning / Environment

- Planning permission for Grain 3 & nitrogen blending plant
- Environmental Agency – Permanent structures below MHWS
- Environmental Agency – Temporary works below MHWS
- Environmental Agency – PPC authorisation
- Environmental Agency – Abstraction Licence
- Environmental Agency – Consent to discharge
- Flood defence consent
- Land drainage consent
- Internal drainage board consent
- Medway Ports – Dredging licence
- Medway Ports – Ship approach and berthing consent
- Medway Ports – River works licence
- Medway Council – Consent to demolish & construct
- Medway Council – ES – Appropriate assessment
- Pipeline safety regulations
- Sec of State for Environment – Consent to undertake marine works
- Translocation licence (water voles)
- Application to emit carbon dioxide under EU emissions trading scheme
- Allocation of carbon dioxide credits under EU emissions trading scheme
- Power connection agreement

Appendix 4 - Request for Proposals Documentation (“RFP”)

Introduction

This appendix contains the documentation sent out to interested parties on 18 January 2006 to request indicative, non-binding proposals from potential Shippers interested in securing capacity at Grain. Since issue of this documentation, the indicative timetable provided has been revised as follows:

Date	Event
18 January 2006	Participation request deadline
18 January 2006	Issue of RFP package
2 February 2006	Stage 1 deadline for written questions
28 February 2006	Submission of Indicative Proposals
12 May 2006	Selection of Stage 2 bidders and issue of package for Firm Proposals
15 September 2006	Submission of Firm Proposals
15 December 2006	Finalisation of sale process of Grain 3 Expansion Capacity



National Grid Grain LNG Limited

**Grain 3 Expansion Project
Request for Proposals for use of
Expansion Capacity at the Isle of Grain LNG
Importation Terminal**

NATIONAL GRID GRAIN LNG LIMITED

18 January 2006

INDEX

1	<i>Introduction</i>	46
2	<i>Stage 1 - Request for Proposals</i>	53
3	<i>Submission and Evaluation of Stage 1 Proposals</i>	56
4	<i>Conditions for Participation in Stage 1</i>	56

Indicative Timetable

Checklist of Information to be Provided

Annexes

Annex 1	Information Memorandum
Annex 2	General Terms and Conditions (“GTCs”)
Annex 3	Draft Specific Terms Agreement (“STA”)
Annex 4	Summary of Network Entry Provisions (“NEPs”)
Annex 5	Summary of Terminal Operating Procedures (“TOPs”)

1 INTRODUCTION

- 1.1 National Grid Grain LNG Limited ("**GLNG**") has developed and is expanding the Grain LNG Terminal (the "**Project**"), a liquefied natural gas ("**LNG**") importation terminal (the "**Terminal**") at the Isle of Grain in the south east of England. GLNG is a wholly owned subsidiary of National Grid plc.

The initial phase of the Project involved converting the existing peak shaving storage facility to accept 3.3 million tonnes per annum (mtpa) of imported LNG, including construction of a jetty and a cryogenic pipeline as well as installation of other ancillary equipment. This phase of the Project was commissioned in July 2005 and is now fully operational.

The second phase ("**Grain 2 Expansion**") of the Project is currently under construction. It involves an expansion of the Terminal by the construction of three additional total containment tanks of 190,000m³ each and ancillary equipment, increasing throughput by a further 6.5mtpa of LNG. It is expected that the Grain 2 Expansion will be completed before winter 2008/9. The Grain 2 Expansion capacity has been fully sold with the exception of 45,000m³ LNG storage capacity.

GLNG now plans a further phase ("**Grain 3 Expansion**") comprising a further development of the Terminal, involving a new jetty and unloading facilities, additional vaporisers and ancillary equipment and potentially additional storage capacity, increasing potential throughput by up to a further 5mtpa of LNG. GLNG currently intends in early Q2 2006 to submit a planning application to Medway Council for the construction of these further expansion facilities. Subject to receiving planning and other consents and an exemption under section 19C of the Gas Act 1986, GLNG currently anticipates being able to provide the additional capacity in time for winter 2010/11, or possibly sooner.

- 1.2 GLNG is seeking proposals from a LNG shipper or shippers ("**Shipper(s)**" or "**Candidate(s)**") for the use of capacity services at the further expanded Terminal. This will include the berthing and unloading of LNG tankers, storage of LNG in purpose-built tanks, regasification of LNG and delivery of gas to the system entry point on the National Transmission System ("**NTS**") operated by National Grid Gas plc ("**NGG**") (formerly Transco plc).
- 1.3 The proposed terms of service are for the selected LNG Shipper(s) to hold rights to:

- (a) LNG delivery capacity (for delivery of regasified LNG at the NTS entry point), of up to 210GWh per day. (It will be the Shipper(s)' responsibility to arrange onward transportation by NGG and obtain system entry capacity. Depending upon the Shipper(s)' requirements the Shipper(s) may need to discuss with NGG the need for reinforcement of NGG's system);
- (b) a corresponding entitlement to berth and unload LNG tankers;
- (c) LNG storage capacity of up to 235,000m³, comprising 45,000m³ uncommitted from the Grain 2 Expansion, and potentially a further 190,000m³ from one additional tank comprised in the Grain 3 Expansion.

As described in the Information Memorandum (Annex 1), the levels of service which GLNG may be able to provide as part of the further expansion are dependent on an option held by one of the existing Shippers – the above are the maximum available levels.

- 1.4 GLNG considers that Annual Berthing Entitlement and Delivery Capacity in the ratio of approximately 0.4 Berthing Slots / GWh/d Delivery Capacity or less will provide reasonable and efficient use of the jetty. However, GLNG does not intend to restrict bids to this ratio within this Request for Proposals.

As respects Storage Capacity, existing Shippers (holding Storage Capacity under the initial phase or Grain 2 Expansion) may be able to enhance their existing service by acquiring additional Berthing Slots and Delivery Capacity, and/or by acquiring all or part of the 45,000m³ Storage Capacity uncommitted from the Grain 2 Expansion. Alternatively Candidates may wish to make proposals which would require the construction (as part of the Grain 3 Expansion) of additional storage capacity.

- 1.5 GLNG intends that the Shipper(s) will be selected according to the following three-stage process:

Stage I – Request for Proposals (the "RFP"):

In response to this RFP package, Candidates are requested to provide details as set out in 2.2 below, of their indicative non-binding proposals, based on the service documentation provided in this RFP, for:

- The Delivery Capacity they would require at the Terminal;

- Whether they require Storage Capacity, and if so what amount;
- Annual Berthing Entitlement (number of berthing slots);
- Their preferred start date (Commercial Operations Date) and Term of any contract for the provision of such services. Candidates should note that the Term may not extend beyond 30 September 2029 in any event; and
- The proposed amount payable as an Annual Capacity Charge in pounds sterling per GWh per Day (£/GWh/Day) of Delivery Capacity.

For Delivery Capacity, Storage Capacity and Annual Berthing Requirement, Candidates are requested to provide both minimum and maximum proposed amounts.

GLNG requires proposals to be of sufficient detail to enable the assessment of the options available and to short-list Candidates to participate in Stage II.

Stage II – Invitation to Submit Firm Proposals ("ISFP"):

Having considered the proposals and accompanying information submitted during Stage I, GLNG intends to issue a revised package to selected Candidates ("**ISFP package**"). This will include additional documents such as the Terminal Operating Procedures ("TOPs") and Network Entry Provisions.

In response to the ISFP package, shortlisted Candidates will be invited to submit firm and binding priced offers with technical and commercial proposals, strictly against documentation and within parameters which will be specified in the ISFP.

Stage III – Award of Contract:

Depending on Candidates' responses to the ISFP package, GLNG may simply accept the proposal that it evaluates to be the most advantageous overall or, alternatively, request one or more Candidates to enter into further negotiations. GLNG however may conclude that none of the proposals forms a satisfactory basis on which to proceed further and may either invite further submissions or terminate the process.

- 1.6 An indication of the anticipated timetable for this process is set out at the end of this document.

- 1.7 Candidates should note that the capacity sale which is proposed in this RFP will only become effective when GLNG has obtained planning consent for the Grain 3 Expansion. This condition precedent is set out in the draft STA (Annex 3). GLNG anticipates submitting a planning application in early Q2 2006, following receipt of indicative bids and following a decision to proceed to the ISFP stage.
- 1.8 GLNG anticipates, and Candidate(s) should bid on the basis, that other requirements, such as an exemption (in respect of the Grain 3 Expansion capacity) under section 19C of the Gas Act 1986, and GLNG having entered into contract(s) for the engineering, procurement and construction of the Grain 3 Expansion will be satisfied ahead, or at the time, of entering into STA(s) with the successful Candidate(s).
- 1.9 Candidates may raise questions in relation to the RFP in written form until and including 2 February 2006. GLNG will issue to all Candidates a collated set of questions and answers.

Written questions should be sent to: GLNG Project,

Attention: Phil Carter, Commercial Director,
National Grid Grain LNG Limited,
National Grid House,
Warwick Technology Park,
Gallows Hill,
Warwick,
Warwickshire,
CV34 6DA,
United Kingdom;
e-mail: phil.carter@uk.ngrid.com.

- 1.10 Candidates may request a meeting with the GLNG team on specific dates, but GLNG may decline such a meeting if it considers that the matters to be discussed may be dealt with by written question and answer. These dates are available through direct contact with Phil Carter or Mark Tunney (mark.tunney@uk.ngrid.com). Following any such meeting, GLNG will circulate to all Candidates a note of any information provided by GLNG during the meeting, where GLNG considers such information to be relevant to Candidates in making their indicative non-binding proposals.

1.11 GLNG will exclude (from collated questions and answers, and notes circulated following meetings with Candidates) any information which GLNG considers to relate to a particular Candidate and to be commercially sensitive. The identity of Candidates raising questions or attending meetings with GLNG will be kept confidential.

2 STAGE I - REQUEST FOR PROPOSALS

- 2.1 This RFP package includes a number of Annexes, which provide information on the Terminal and its principal contracts and will allow interested parties to develop proposals. The Annexes are described below:

Annex 1: Information Memorandum

This sets out further details about GLNG, the initial phase and Grain 2 Expansion and the associated releases of capacity, and the proposed Grain 3 Expansion of the Terminal;

Annex 2: General Terms and Conditions ("GTCs")

These are the current general terms and conditions on which GLNG provides the services at the Terminal. The ISFP (in Stage 2) will include the then-current version of the GTCs, on which final proposals are to be made;

Annex 3: Draft Specific Terms Agreement ("STA")

This sets out the specific and any special provisions applicable to a particular Shipper(s). Together with the GTCs, the STA will form the basis of the agreement between GLNG and the Shipper(s).

Attached to the draft STA are 3 notices previously issued to Shippers by GLNG which set out details of certain decisions and determinations already made by GLNG pursuant to the GTCs. These notices are binding on all Shippers. The final STA will attach the prevailing notices at the time of its signature;

Annex 4: Summary of Network Entry Provisions for the relevant entry points ("NEPs")

The NTS Network Entry Provisions set out the operating interfaces between the Terminal and NGG's National Transmission System (NTS). They contain a number of parameters and rules relevant to the Shipper(s) (and the corresponding user of the NTS).

The LDZ Network Entry Provisions set out the operating interfaces between the Terminal and Southern Gas Networks Limited's gas pipeline system (South East LDZ). They contain a number of parameters and rules relevant to the Shipper(s) (and the corresponding user of the South East LDZ).

The ISFP will contain the NEPs in full;

Annex 5: Summary of Terminal Operating Procedures ("TOPs")

The TOPs set out more detailed operating procedures applicable to the Terminal. The ISFP will contain the prevailing version of the TOPs in full.

2.2 Candidates are therefore invited to submit their indicative, non-binding proposals, including the following documents and information:

2.2.1 Indicative non-binding proposal

Candidates should provide the following details of their indicative non-binding proposal:

- The proposed Annual Capacity Charge rate in pounds sterling per GWh per day (£/GWh/d), and total annual amount in pounds sterling (£);
- Preferred total Storage Capacity, if any, in cubic metres (m³);
- Preferred Delivery Capacity in GWh/d;
- Preferred Annual Berthing Entitlement (number of berthing slots) per annum;
- Preferred Commercial Operations Date (start date for expansion capacity to be made available);
- The proposed contract Term (not beyond 30 September 2029);
- Any other relevant requirements or information.

In relation to Storage Capacity, Delivery Capacity and Annual Berthing Entitlement, Candidates should provide maximum and minimum acceptable amounts. Candidates may propose different rates for the Annual Capacity Charge by reference to their maximum and minimum proposed Delivery Capacities.

The indicative Annual Capacity Charge rate should assume that the Terminal operating costs, excluding amounts which the GTCs provide to be separately recoverable from Shipper(s), are paid by GLNG.

2.2.2 Sources and composition of LNG

Candidates should provide information on LNG to be unloaded at the Terminal, including:

- A description of the likely source of LNG and its composition;
- Details of the type, size and dimensions of LNG tankers that the Shipper(s) would bring to the Terminal; and
- The expected round trip voyage duration to the Isle of Grain.

2.2.3 Relevant background information

Candidates are invited to include such information regarding their relevant experience, expertise and financial standing, as they consider appropriate to establish their suitability as Shipper(s) under the proposed contract. Such information should include:

- A description of the Candidate's organisational/corporate structure, with explicit reference to their LNG interests;
- Identity of the proposed contracting entity and proposed guarantor. GLNG will require a contracting entity, or guarantor within the Shipper(s)' group, with at least an investment grade credit rating;
- Annual reports (or equivalent documents) and supporting financial statements, including descriptions of operations, operating revenue, total assets, balance sheet audited by a certified public accounting firm for the preceding two fiscal or reporting years; group credit rating and proposed contracting entity credit rating;
- A description of the Candidate's experience in all elements of the LNG chain: production, liquefaction, transportation, selling, trading, importing, and downstream gas marketing and their strategy going forward;
- A description of the Candidate's operational flexibility in relation to the variables which may be encountered in start-up and operation of the Grain 3 Expansion capacity; and
- Brief biographical details of individuals in the Candidate's bid team.

2.2.4 Technical/commercial assumptions

Where different from or additional to those contained in the GTCs and draft STA, any technical or commercial assumptions on which the Candidate's proposed Annual Capacity Charge would be based.

- 2.3 GLNG would welcome proposals that may include strategic options.
- 2.4 It should be noted that in finalising the basis on which GLNG invites firm proposals under the ISFP, GLNG makes no commitment to take account of any proposal, comment or modification suggested by any Candidate, and may make such other modifications as it sees fit to the arrangements described in this RFP.

3 SUBMISSION AND EVALUATION OF STAGE I PROPOSALS

- 3.1 Proposals in response to this RFP shall be enclosed in a sealed envelope marked with the name and address of the Candidate and the date of submission of the proposal. The front of the envelope shall be marked with "Stage I Proposal for Grain 3 Expansion".
- 3.2 Candidates shall deliver their Stage I proposals by hand or by registered mail to GLNG Project, attention Phil Carter, Commercial Director, National Grid Grain LNG Limited, National Grid House, Warwick Technology Park, Gallows Hill, Warwick, Warwickshire, CV34 6DA, United Kingdom. To be eligible, they must be received before noon on 28 February 2006. GLNG reserves the right to reject any Stage I proposal that it receives after this time.
- 3.3 GLNG may request clarification or explanation from Candidates in respect of the contents of any part of their Stage I proposals. Any such clarification or explanation shall thereupon form part of the Candidate's Stage I proposal.
- 3.4 GLNG will evaluate the Candidates' Stage I proposals against predetermined evaluation criteria and will select a shortlist of Candidates whose proposals are considered to be the most advantageous to GLNG. Short-listed Candidates will be invited to participate in Stage II. Candidates who have submitted a Stage I proposal will be notified as to whether or not they have been short-listed to participate in Stage II by the start of the Stage II process (see 3.5 below).
- 3.5 GLNG expects that the proposals made in Candidates' stage I submissions will provide GLNG with the information to enable it to finalise the bid package and to issue a revised package to Candidates short-listed to participate in Stage II, capturing one or more of the commercial and technical options which are of most

interest to GLNG. The indicative timetable shows GLNG's intention to complete the evaluation of Stage I proposals, the short-listing of Candidates for Stage II, the revision of the documents and issue of the revised package within approximately six weeks from the receipt of the Stage 1 bids. This timetable will, however, remain flexible until the nature and extent of Candidates' proposals in their Stage I submissions are known.

- 3.6 The procedure for submission of Stage II proposals, the required validity period and all other terms and conditions on which short listed Candidates may participate in Stage II will be set out in the ISFP itself.

4 CONDITIONS FOR PARTICIPATION IN STAGE I

By applying for this RFP package and submitting their proposals in response, Candidates are deemed to have accepted the following conditions.

- 4.1 Candidates shall comply strictly with the terms of a Confidentiality Agreement that each Candidate shall have signed prior to receiving this RFP package.
- 4.2 In submitting proposals in response to this RFP package Candidates shall comply strictly with all the requirements of this RFP package.
- 4.3 Any Candidate who is found by GLNG at any time to have discussed its response to this RFP, or to have exchanged information, with any other Candidate or to have committed any unlawful act(s) including but not limited to any act of collusion or bribery in relation to this RFP may, at the sole discretion of GLNG be disqualified from further participation, without prejudice to any rights and remedies to which GLNG may be entitled in respect of such act(s). However parties may submit joint proposals where such arrangements are expressly communicated to and permitted by GLNG in writing.
- 4.4 All documents, whether as drawings, calculations, data or as any other form of information issued with or in connection with this RFP (including in response to written questions), are issued to Candidates solely for the purpose of this RFP and are not to be copied, or communicated to third parties or used for any other purpose whatsoever.
- 4.5 The documents and information in this RFP package have been prepared in good faith. They, however, do not purport to be comprehensive and in some cases they remain provisional. Accordingly, GLNG accepts no liability or responsibility for their

accuracy or completeness and makes no representation, express or implied, with respect to the information contained in this RFP package, or with respect to any further written or oral information subsequently given in connection with this RFP package, including in response to any written question. Any such liability is therefore expressly disclaimed.

- 4.6 GLNG may notify to all Candidates any question, clarification or comment put to GLNG (and GLNG's response) by any Candidate during the course of this RFP process. The identity of the Candidate raising the question, clarification or comment will not be disclosed. Similarly, in Stage II, the ISFP documentation issued to all shortlisted Candidates may reflect any comment, modification or idea proposed by any Candidate during the Stage I process.
- 4.7 While the contents of this RFP package sets out the present intentions and expectations of GLNG as to the steps it proposes to take in order to select a suitable Shipper(s), GLNG reserves the right, at any time and at its sole discretion to change the procedure outlined in this RFP package for selection of a Shipper(s), or to terminate the process entirely, or to disqualify or discontinue discussions with any Candidate or not to short-list or to remove from any short-list, any Candidate for any reason and without being obliged to give reasons.
- 4.8 Accordingly, by submitting a proposal in response to this RFP package, each Candidate agrees that neither GLNG nor any officer or employee of GLNG shall bear any liability to the Candidate in respect of any refusal or failure to accept the Candidate's proposal, the failure of the Candidate to gain selection to any shortlist or to be invited to any negotiations or to be awarded any contract, or any costs or expenses related to the proposal, or any loss or damages arising out of the RFP process or in respect of any other matter arising from this RFP process. The Candidate accepts the RFP package and submits a proposal entirely at its own risk.
- 4.9 English Law governs this RFP.

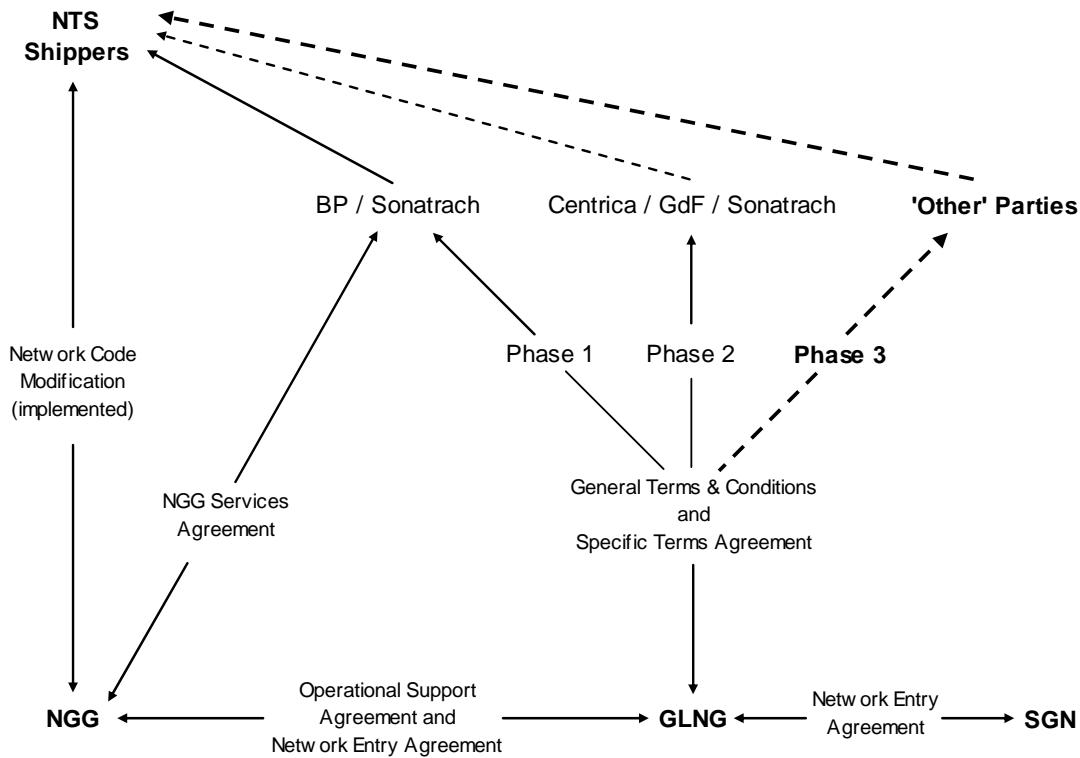
NATIONAL GRID GRAIN LNG LIMITED**Expansion Capacity Request for Proposals****Indicative Timetable**

Date	Event
18 January 2006	Participation request deadline
18 January 2006	Issue of RFP package
2 February 2006	Stage 1 deadline for written questions
28 February 2006	Submission of Indicative Proposals
12 April 2006	Selection of Stage 2 bidders and issue of package for Firm Proposals
5 July 2006	Submission of Firm Proposals

NATIONAL GRID GRAIN LNG LIMITED**Expansion Capacity Request for Proposals****Checklist of Information to be Provided for this RFP**

1. Indicative non-binding commercial proposals as to services required:
 - Annual Capacity Charge (£/GWh/d) and total annual amount (£);
 - Preferred total Storage Capacity (m³);
 - Preferred Delivery Capacity (GWh/day) and total LNG throughput in million tonnes per annum (mtpa);
 - Preferred Annual Berthing Entitlement (number of berthing slots);
 - Preferred Commercial Operations Date from which capacity will be available;
 - Preferred Contract Term (not beyond 30 September 2029);
 - Maximum and minimum levels of Storage Capacity, Delivery Capacity and Annual Berthing Entitlement and associated Annual Capacity Charge.
2. LNG and shipping information, including:
 - (a) Likely LNG source;
 - (b) Likely LNG composition;
 - (c) Details of proposed LNG tankers;
 - (d) Estimated round trip voyage duration.
3. General information including:
 - (e) Candidate's organisational structure;
 - (f) Identity and credit rating of contracting entity and guarantor where required;
 - (g) Annual reports (or equivalent) and supporting financial statements;
 - (h) Candidate's LNG experience;
 - (i) Candidate's start up and operational flexibility;
 - (j) Individuals' biography.
4. Any other technical or commercial assumptions.
5. Any other information.

Appendix 5 - Contract Structure



Notes:

NGG may also wish to enter into bilateral ("TSA" type) contracts with expansion capacity holders for economic purchasing and System Operator incentive reasons.

Excludes GLNG ancillary contracts e.g. for utilities and provision of third party blending services and construction contracts.

Appendix 6 - Summary of Proposed Access Terms

A Summary of the Proposed Access Terms

for the

Isle of Grain LNG Importation Terminal

Introduction

National Grid Grain LNG Limited (GLNG) has transformed the LNG storage site at Isle of Grain into an LNG import terminal (the GLNG **terminal**). The terminal allows LNG to be imported, unloaded, stored, regassified and delivered to the national transmission system (**NTS**). GLNG is offering further capacity at the terminal via a Request for Proposals process, which will allow shippers to bid for capacity at the terminal.

This note outlines the terms on which GLNG will allow shippers to use the terminal. GLNG's proposals are subject to its obtaining an acceptable offer to enter into an General Terms Agreement (GTC's) and Specific Terms Agreement (STA). GLNG intends this latest access contract to be for up to 235,000m³ of storage capacity at the terminal, and on a long term basis of up to 20 years. The shipper will be given the option to book both additional storage, berthing slots and delivery capacity.

GLNG may contract with new or existing shippers (or a combination of both new and existing shippers). However, due to the amount of additional throughput capacity being offered (c5mtpa), no more than two new shippers could be accommodated at the terminal.

GLNG has currently received indicative (non-binding) bids from a number of shippers.

Allocation of capacity, etc

The relevant shipper will hold for the term of its STA:

- (i) an annual berthing entitlement, allowing the shipper a specified number of berthing slots (to berth and unload an LNG tanker) each year;
- (ii) a specified amount of storage capacity representing the maximum quantity of LNG which may be stored pending its regassification; and
- (iii) a specified amount of delivery capacity, in GWh/day, representing the maximum rate at which the shipper's LNG may be regassified and delivered to the NTS.

The shipper will pay an annual capacity charge based on the amount of delivery capacity which it holds.

The specific amount of delivery capacity, storage capacity and berthing slots allocated to the shipper, the rate of the annual capacity charge payable by that shipper, and the term will be set out in the STA.

Outline of basic terms

The GTCs contain the rules applicable to the shipper's use of its capacity, a brief summary of these are as follows:

- (i) before the beginning of each year each shipper will notify to GLNG its preferred berthing dates. Based on this information, GLNG will establish an annual unloading programme for the terminal.
- (ii) there are rules and procedures for each berthing and unloading, to ensure safe and efficient turnaround of LNG tankers. GLNG and shippers will be disincentived from causing delay to the efficient unloading at the terminal. The shipper is not permitted (without GLNG agreement) to unload (or berth) unless it has at the time sufficient available capacity to accommodate the LNG tanker cargo.
- (iii) the shipper is entitled to hold LNG in storage, up to its maximum storage capacity.
- (iv) provided the shipper has sufficient LNG-in-store, the shipper is entitled to nominate (and renominate, within day) gas for delivery to the NTS, at a daily rate up to its delivery capacity.
- (v) certain overrun charges may be payable by the shipper where, for example, it overfills its storage capacity, over-depletes its LNG-in-store, or nominates gas for delivery at a rate in excess of its delivery capacity.
- (vi) some further details are as follows:
 - GLNG will deduct shrinkage from LNG-in-store in order to cover fuel and losses;
 - the natural gas boil-off from stored LNG is delivered to the LDZ or NTS and allocated each day to shippers;
 - each shipper is required to maintain at all times a minimum inventory of LNG, to ensure that the storage tanks and unloading line always remain cold;
 - the shipper will be responsible for booking NTS entry capacity and making arrangements to take gas away from the exit of the terminal.

Transfers of capacity

Under the GTCs a shipper may transfer to another shipper any of its delivery capacity, storage capacity or berthing entitlement, and/or LNG-in-store. A transfer of delivery capacity or storage capacity will be for a specified period. A transfer of berthing entitlement may be in advance of the relevant year or the transfer of a fixed berthing slot within-year. The transferor remains liable for the annual capacity charge.

The transferee must be a 'shipper', that is a party who has signed an STA to bind itself to the GTCs. GLNG may enter into an STA with a shipper under which the shipper holds no allocation of capacity, to enable the shipper to have transfers to it.

Additional capacity

The GTCs allow GLNG to allocate to any shipper '**additional capacity**' for a given period, that is delivery capacity, storage capacity or berthing entitlement which GLNG determines that it can make available without breach of its obligations to existing shippers. As above, a party may sign an STA in order to become a shipper to obtain additional services.

The GTCs do not prescribe how GLNG will determine what additional capacity it can make available, or place any contractual obligation on GLNG to allocate additional capacity, but they make it clear that no shipper has the right to prevent GLNG from doing so. The GTCs provide for shippers to pay charges in respect of additional capacity, at the rates for the time being published by GLNG. The GTC's specifically contemplate the possibility of allocation and pricing by auction.

GLNG may have additional capacity to allocate where there is physical capacity which has not been allocated long term to a shipper.

Existing and planned available NTS entry capacity at the Isle of Grain is not anticipated to be sufficient to accommodate this latest capacity being offered to the market. The shippers will have to bid into the National Grid annual auctions to secure further NTS capacity.

With regards the implementation of suitable 'anti hoarding' mechanisms in relation with this additional capacity, GLNG intends to include provisions to oblige any new shippers to introduce a secondary trading mechanism similar to that being introduced by the Grain 1 primary capacity holder, BP/Sonatrach.

Appendix 7 - Competition Study by Frontier Economics

Appendix 8 – Comparison of Grain (post Grain 3) with Centrica’s Rough facility

1. As noted in paragraph 7.35 above, given the size of the Grain facility post Grain 3, comparisons could be made between Grain and Centrica’s storage facility at Rough (the use of which is subject to stringent regulatory controls). In view of this, the following commentary (including an assessment against the economic analysis undertaken by the Competition Commission into its Inquiry into Rough) demonstrates how Grain is actually more comparable with other beach terminals rather than a long range storage facility and that it should raise no regulatory concerns. Further, this is also against the backdrop that Rough ownership by Centrica represented vertical integration of a market player operating storage capacity infrastructure. NGG and GLNG are not market players and hence there should be no such concerns at Grain where GLNG sells all capacity to a variety of market players.
2. The above matter is addressed in three parts as follows:
 - I. Comparison of Grain with Centrica’s Rough facility (to demonstrate Grain is actually more comparable with other beach terminals rather than a long range storage facility);
 - II. Compliance with the Competition Commission’s criteria as placed on Rough (though given (I) above, this could be construed as irrelevant); and
 - III. Impact on competition if Centrica was to secure Grain 3 capacity.

(I) Comparison of Grain with Centrica’s Rough facility

3. In relation to swing capability/flexibility, to ensure consistency with the Competition Commission’s analysis in respect of Centrica’s purchase of the Rough facility we have used the same definition of flexibility as used by the Competition Commission: that is, a measure of the peak flows from the facility relative to the daily average gas supplied throughout the year. Conducting this analysis for GLNG (with phase 3 operational) demonstrates that the percentage swing capability of GLNG (with phase 3) is of a similar order to that of beach supplies (120%)²⁵. In the Rough investigation this level of swing was considered by the Competition Commission to be, at best, only sufficient to make beach supplies a weak substitute for gas storage. Therefore, we can consider GLNG to be at most, a weak substitute for Rough storage gas.
4. The weakness of GLNG as a substitute for Rough as a swing provider is reinforced by the practicalities of utilisation of the facility once phase 3 of the project becomes operational. Once Grain 3 is operational, the utilisation of the jetties to achieve baseload throughput will lead to there being around two ships every three days. This will largely fill the capacity of the two jetties with tanker delivery slots anticipated to be more closely aligned to the tidal cycles in the Medway estuary. In short, this means that, even if spare re-gasification capacity were used to boost deliveries into the system in the short term, there would be little or no opportunity to accelerate the ship berthing/unloading profile. Consequently, more gas could not be imported into the facility to enable the flows from GLNG over the winter period (or the 67 day period over which Rough is able to export) to remain high relative to the capacity sold under contract. In effect, this means that higher than contracted flow-rates could not be

²⁵ This is based on an assessment of plant design & operational constraints, the portfolio of shippers utilising the terminal and the inability of a proportion of them to increase flow rates pending arrival of an imminent tanker, plus an expected limit on NTS entry capacity above baseline.

sustained for long enough periods to make the capacity held at GLNG anything other than a very weak substitute for Rough.

5. Furthermore, on completion of Grain 3, the facility will have an importation capacity of c15mtpa (20bcm/y), slightly more than BBL (16bcm/y) but less than South Hook (21bcm/y), I(UK)(24bcm), and Ormen Lange (25bcm/y). While offshore pipelines do not have regulated third party access they do operate under a negotiated third party access regime whereas South Hook and BBL both benefit from exemptions. GLNG is not aware that similar concerns were raised in their exemption requests, despite there being, similar potential vertical integration issues to those that arose at Rough.
6. In other words, as it is now, the UK will be dominated by a relatively small number of relatively large entry points, and Grain should raise fewer concerns than most in relation to this issue given the nature of its open season process which has greater affinity with a regulated third party access regime and the number of parties who will have capacity rights at the terminal as a result.

(II) Compliance with Competition Commission's criteria as placed on Rough

7. As noted above, given GLNG considers the Grain facility to be more comparable with other beach supplies rather than Centrica's Rough storage facility, this issue could be construed as irrelevant. Nevertheless, for completeness, the commentary below demonstrates how Grain can be considered compliant with the Competition Commission's criteria as placed on Rough.
8. GLNG has considered the findings of the Competition Commission in its report on the merger of Dynegy Storage Ltd and Dynegy Onshore Processing Ltd and Centrica plc. The public interest issues raised in that inquiry were whether or not Centrica would be likely to withhold sources of flexible gas in order to force up wholesale gas prices. The Competition Commission concluded that Centrica had the ability to do this and that such a strategy could be profitable. The Competition Commission concluded that in the absence of further constraints Centrica may be expected to:
 - a) discriminate between customers in giving access to Rough;
 - b) use to its advantage sensitive information gained from the operation of Rough;
 - c) withhold information about the operation of Rough;
 - d) be less innovative in marketing Rough products than another owner; and
 - e) invest less in expanding Rough's capacity than another owner.
9. As such, competition in the markets for domestic gas supply and flexible gas was considered likely to be weakened unless remedies were prescribed.
10. It is to be noted that the expectation that Centrica might behave in the ways outlined above, only arose as a result of the vertically integrated structure of Centrica plc. As a result, the remedies proposed sought to remove the ability for Centrica to engage in the apprehended manner and were that Centrica must:
 - a. sell Rough's full capacity on non-discriminatory terms, retaining the existing Storage Services Contract (SSC);
 - b. auction all capacity remaining unsold no less than 30 days before the start of each storage year, with no reserve price;

- c. not participate in the primary sale process but reserve no more than 20% of Rough's existing nominal capacity for itself in the first year (2004/05) falling to 15% over five years and remaining at that level thereafter: the aim of this remedy is to give Centrica an incentive to invest in expanding Rough's capacity, because Centrica would be able to retain any incremental capacity for its own use;
 - d. maintain legal, financial and physical separation between its storage business and all other parts of the group; ensure that no commercially sensitive information arising from the operation of Rough is passed to other parts of Centrica; and make any disclosure of information relating to the storage operations to all market participants simultaneously;
 - e. facilitate the efficient operation and development of the secondary market in Rough capacity;
 - f. offer at least 20% of Rough's capacity on annual contracts; capacity should also be offered on a range of other durations and with the possibility of fixed or indexed pricing; and
 - g. arrange for an independent review of compliance with all undertakings by Centrica's Audit Committee, with annual reports to the Office of Fair Trading and the Office of Gas and Electricity Markets.
11. In considering the remedies above it is apparent that GLNG, although not vertically integrated with an incumbent supplier or producer, already offers an access regime that incorporates many features of the remedies proposed. For example, GLNG's capacity is already sold on non discriminatory terms through an open season process comparable with remedy (a) above.
12. Since the facility is built to a size which matches the capacity sold, withholding capacity from the primary market is illogical and could provide no economic or commercial benefit to GLNG (as well as potentially placing GLNG in breach of its contractual obligations). As a result, there should be no requirement to consider remedies equivalent to (b) and (f).
13. In any event, the structure and operations of GLNG are such that measures equivalent to remedies (b) to (e) are already in place. For example:
- (i) GLNG is legally and financially separate from (a) any of its customers and (b) the owner and operator of the transportation systems to which it connects;
 - (ii) GLNG is subject to the same information provision requirements that apply at all beach entry points; and
 - (iii) legal and financial separation is also a pre-requisite for gaining an exemption.
14. As such, its structure and obligations are already equivalent to the remedies imposed on Centrica at (d) above. As a result, no change to the structure and obligations of GLNG would need to be imposed on GLNG to achieve an equivalent situation to that resulting from the obligations placed on Centrica at remedy (d) above (even if it were required, which GLNG considers it is not).
15. By the same logic, remedy (c) is irrelevant since GLNG has no use for any capacity retained for its "own purposes". This is because GLNG is prohibited, by virtue of being an affiliate of National Grid Gas, from purchasing gas or capacity rights with the intention of subsequently reselling or otherwise disposing of them to third parties: this is the effect of Special Condition C4 (Prohibited Procurement Activities) and

Special Condition D4 (Prohibited Procurement Activities) of National Grid Gas's gas transporter licences in respect of the NTS and retained distribution networks respectively. As such, GLNG does not have any of its "own purposes" for which it could be tempted to retain capacity.

16. Finally, provisions equivalent to remedy (e) are already a feature of the general terms and conditions of contract for use of GLNG's facility, fully supporting the ability of primary capacity holders to sell capacity on the secondary market.
17. Through an exemption, GLNG fully expects Ofgem to reserve rights to access information it deems necessary to access to maintain effective surveillance of the operation of any exemption granted. As such this reservation of rights will afford Ofgem the ability to monitor whether or not the arrangements at GLNG are materially different from those described in this exemption application or whether the actions of any of its customers give cause for any concern. Ultimately, this could lead to any exemption being revoked.
18. Having looked at the remedies proposed for Centrica and its purchase of the Dynegy Storage business, it appears to GLNG that all of these remedies are already present within either the terms of the contract, the capacity sales process or the industry operating framework even though the lack of vertical integration could not give rise to the same concerns as those identified by the CC in relation to Centrica's acquisition of Rough.
19. In addition to the above, and again, as noted in paragraph 7.35, in relation with the above matter, the economic assessment carried out by Frontier Economics also considers the different markets for gas flexibility and the seasonal storage market in particular given this was the market deemed to be relevant by the Competition Commission in its Rough inquiry. The conclusion of this particular economic analysis shows that no competition concerns exist even if Centrica were to secure all of the capacity rights of Grain 3 in addition to its existing capacity rights secured in phase 2.

III. Impact on competition if Centrica was to secure Grain 3 capacity.

20. When looking at the public interest issues it is apparent that any issue that involves withholding of unused capacity from the market by the primary capacity holders can be adequately dealt with through the latest UIOLI proposals. That said, to ensure our competition analyses deal with any suggestion that were the capacity of phase 3 to be secured by Centrica (in addition to the flexible capacity it holds at Rough), Frontier Economics have looked more closely at the market for gas flexibility and the seasonal storage market in particular; since this was a market deemed to be relevant by the Competition Commission in its Rough inquiry.
21. Analysis has been carried out into the effect on market shares of the seasonal flexibility market, albeit with the remedies for Rough intact and operating. This analysis indicates that no competition concerns are evident. More detailed analysis is presented in the competition study (see Appendix 7).

Appendix 9 - Licence Conditions / Gas Act Obligations**Standard Special Condition A6 - Conduct of Transportation Business**

1. The licensee shall conduct its transportation business in the manner best calculated to secure that neither -
 - (a) the licensee or any affiliate or related undertaking of the licensee (including, for the avoidance of doubt, any other relevant gas transporter which is also owned by the holder of this licence, the licence for which is held in the same legal entity);
 - (b) any gas shipper or gas supplier; nor
 - (c) any DN operator (who has entered into transportation arrangements with other relevant gas transporters),
obtains any unfair commercial advantage including, in particular, any such advantage from a preferential or discriminatory arrangement, being, in the case of such an advantage accruing to the licensee, one in connection with a business other than its transportation business.
2. In this condition "**transportation business**" shall have the meaning given in Standard Special Condition A3 (Definitions and Interpretation) and in addition it shall also include -
 - (a) **LNG storage arrangements**, the provision of metering services and meter reading services; and
 - (b) if the licensee has been designated as the designated registrar of pipes pursuant to Standard Special Condition A49 (Designated Registrar of Pipes), the functions of the designated registrar of pipes.
3. If the Authority, having regard, in particular, to any representations made to it by the licensee and other persons as to the extent to which there is competition in relation to the storage of gas in LNG storage facilities and its view on that question, considers it appropriate that this condition should be modified by the omission of the reference to LNG storage arrangements in paragraph 2(a) then the reference shall be omitted with effect from a date specified in a notice published by the Authority for that purpose; and the definition of "transportation business" contained in Standard Special Condition A3 (Definitions and Interpretation) shall apply to this condition subject to any amendments made by the remaining sections of paragraph 2.
4. If the Authority, having regard, in particular, to any representations made to it by the licensee and other persons as to the extent to which there is competition in relation to either metering or meter reading and its view on that question, considers it appropriate that references to either the provision of metering services or of meter reading services should be deleted from the definition of "transportation business" contained in paragraph 2 for the purpose of this condition, those references shall cease to have effect from the date or dates specified in a notice published by the Authority for that purpose.

Standard Special Condition A26 - Provision of Information to the Authority

1. Subject to paragraphs 5 and 7, the licensee shall furnish the Authority, in such manner and at such times as the Authority may reasonably require, such information and shall procure and furnish to it such reports, as the Authority may reasonably require or as may be necessary for the purpose of performing -
 - (a) the functions conferred on the Authority by or under the Act; and
 - (b) any functions transferred to or conferred on the Authority by or under the Utilities Act 2000.
2. The licensee shall procure from each company or other person which the licensee knows or reasonably should know is at any time an ultimate controller of the licensee a legally enforceable undertaking in favour of the licensee in a form specified by the Authority that that ultimate controller ("**the information covenantor**") will give to the licensee, and will procure that any person (including, without limitation, a corporate body) which is a subsidiary of, or is controlled by, the information covenantor (other than the licensee and its subsidiaries) will give the licensee, all such information as may be necessary to enable the licensee to comply fully with the obligation imposed on it in paragraph 1. Such undertaking shall be obtained within 7 days of such corporate body or other person in question becoming an ultimate controller of the licensee and shall remain in force for so long as the licensee remains the holder of this licence and the information covenantor remains an ultimate controller of the licensee.
3. The licensee shall deliver to the Authority evidence (including a copy of each such undertaking) that the licensee has complied with the obligation to procure undertakings pursuant to paragraph 2, and shall comply with any direction from the Authority to enforce any undertaking so procured.
4. The licensee shall not, save with the consent in writing of the Authority, enter (directly or indirectly) into any agreement or arrangement with any ultimate controller of the licensee or, where the ultimate controller is a corporate body, any of the subsidiaries of such a corporate ultimate controller (other than the subsidiaries of the licensee) at a time when:
 - (a) an undertaking complying with paragraph 2 is not in place in relation to that ultimate controller; or
 - (b) there is an unremedied breach of such undertaking; or
 - (c) the licensee is in breach of the terms of any direction issued by the Authority under paragraph 3 of this condition.
5. The licensee shall not be required by the Authority to furnish it under this condition with information for the purpose of the exercise of its functions under section 34 of the Act.
6. The licensee shall, if so requested by the Authority, give reasoned comments on the accuracy and text of any information or advice (so far as relating to its activities as holder of a gas transportation licence) which the Authority proposes to publish pursuant to section 35 of the Act.

7. This condition shall not require the licensee to produce any documents or give any information which it could not be compelled to produce or give in evidence in civil proceedings before a court.
8. The power of the Authority to call for information under this condition is in addition to the power of the Authority to call for information under or pursuant to any other condition. There shall be a presumption that the provision of information in accordance with any other condition is sufficient for the purposes of that condition, but that presumption shall be rebutted, if the Authority states in writing that in its opinion such further information is, or is likely to be, necessary to enable it to exercise functions under the condition in question.

Standard Special Condition A35 - Prohibition of Cross-Subsidies

1. The licensee shall procure that the transportation business shall not give any cross subsidy to, or receive any cross-subsidy from, any other business of the licensee or of an affiliate or related undertaking of the licensee.
2. In the event that the holder of this licence also owns one or more relevant gas transporters, the licences for which are held in the same legal entity, such that the holder of this licence is:
 - (a) an NTS operator; and/or
 - (b) a DN operator,

the licensee acting as either an NTS operator or a DN operator, as the context requires, shall procure that:

- (i) it shall neither give any cross-subsidy to, or receive any cross-subsidy from, directly or indirectly, a DN operator or any other business operated by the holder of this licence pursuant to any such other gas transporter licence held by the holder of this licence; and/or
 - (ii) it shall neither give any cross-subsidy to, or receive any cross-subsidy from, directly or indirectly, an NTS operator or any other business operated by the holder of this licence pursuant to any such other gas transporter licence held by the holder of this licence.
3. If applicable, where the licensee is a DN operator that operates more than one Distribution Network (as defined in Special Condition E2A (Revenue Restriction Definitions in respect of the Distribution Network)) no such Distribution Network shall be operated in a manner that gives any cross-subsidy to, or receives any cross-subsidy from, any other such Distribution Network.

Condition 45 - Undertaking from Ultimate Controller

1. The licensee shall procure from each company or other person which is at any time an ultimate controller of the licensee a legally enforceable undertaking in favour of the licensee in the form specified by the Authority that that ultimate controller ("the covenantor") will refrain from any action, and will procure that any person (including, without limitation, a corporate body) which is a subsidiary of or controlled by, the covenantor (other than the licensee and its subsidiaries) will refrain from any action, which would then be likely to cause the licensee to breach any of its obligations under the Act or this licence. Such undertaking shall be obtained within 7 days of the company or other person in question becoming an ultimate controller and shall remain in force for as long as the licensee remains the holder of this licence and the covenantor remains an ultimate controller of the licensee.
2. The licensee shall:
 - (a) deliver to the Authority evidence (including a copy of each such undertaking) that the licensee has complied with its obligation to procure undertakings pursuant to paragraph 1;
 - (b) inform the Authority immediately in writing if the directors of the licensee become aware that any such undertaking has ceased to be legally enforceable or that its terms have been breached; and
 - (c) comply with any direction from the Authority to enforce any such undertaking; and shall not, save with the consent in writing of the Authority, enter (directly or indirectly) into any agreement or arrangement with any ultimate controller of the licensee or any of the subsidiaries of any such corporate ultimate controller (other than the subsidiaries of the licensee) at a time when –
 - (i) an undertaking complying with paragraph 1 is not in place in relation to that ultimate controller; or
 - (ii) there is an unremedied breach of such undertaking; or
 - (iii) the licensee is in breach of the terms of any direction issued by the Authority under paragraph 2 of this condition.

Standard Special Condition A39 - Indebtedness

1. In addition to the requirements of Standard Special Condition A27 (Disposal of Assets), the licensee shall not without the prior written consent of the Authority (following the disclosure by the licensee of all material facts):
 - (a) create or continue or permit to remain in effect any mortgage, charge, pledge, lien or other form of security or encumbrance whatsoever, undertake any indebtedness to any other person or enter into any guarantee or any obligation otherwise than:
 - (i) on an arm's length basis;
 - (ii) on normal commercial terms;
 - (iii) for a permitted purpose; and
 - (iv) (if the transaction is within the ambit of Standard Special Condition A27 (Disposal of Assets)) in accordance with that condition;
 - (b) transfer, lease, license or lend any sum or sums, asset, right or benefit to any affiliate or related undertaking of the licensee otherwise than by way of:
 - (i) a dividend or other distribution out of distributable reserves;
 - (ii) repayment of capital;
 - (iii) payment properly due for any goods, services or assets provided on an arm's length basis and on normal commercial terms;
 - (iv) a transfer, lease, licence or loan of any sum or sums, asset, right or benefit on an arm's length basis, on normal commercial terms and made in compliance with the payment condition referred to in paragraph 2;
 - (v) repayment of or payment of interest on a loan not prohibited by subparagraph (a);
 - (vi) payments for group corporation tax relief or for the surrender of Advance Corporation Tax calculated on a basis not exceeding the value of the benefit received; or
 - (vii) an acquisition of shares or other investments in conformity with paragraph 2 of Standard Special Condition A36 (Restriction on Activity and Financial Ring Fencing) made on an arm's length basis and on normal commercial terms, provided, however, that the provisions of paragraph 3 below shall prevail in any of the circumstances described or referred to therein;
 - (c) enter into an agreement or incur a commitment incorporating a cross-default obligation; or
 - (d) continue or permit to remain in effect any agreement or commitment incorporating a cross-default obligation subsisting at 13 December 1999, save that the licensee may permit any cross-default obligation in existence at that date to remain in effect for a period not exceeding twelve months from that date, provided that the cross-default obligation is solely referable to an instrument relating to the provision of a loan or other financial facilities granted prior to that date and the terms on which those facilities have been made available as subsisting on that date are not varied or otherwise made more onerous, provided, however, that the provisions of sub-paragraphs (c)

and (d) shall not prevent the licensee from giving any guarantee permitted by and compliant with the requirements of sub-paragraph (a).

2. The payment condition referred to in paragraph 1(b)(iv) is that the consideration due in respect of the transaction in question is paid in full when the transaction is entered into unless either:
 - (a) the counter-party to the transaction has and maintains until payment is made in full an investment grade issuer credit rating; or
 - (b) the obligations of the counter-party to the transaction are fully and unconditionally guaranteed throughout the period during which any part of the consideration remains outstanding by a guarantor which has and maintains an investment grade issuer credit rating.
3. Except with the prior consent of the Authority, the licensee shall not enter into or complete any transaction of a type referred to or described in paragraph 1(b) save in accordance with paragraph 4, if:
 - (a) the licensee does not hold an investment grade issuer credit rating;
 - (b) where the licensee holds more than one issuer credit rating, one or more of the ratings so held is not investment grade; or
 - (c) any issuer credit rating held by the licensee is BBB- by Standard & Poor's Ratings Group or Fitch Ratings Ltd or Baa3 by Moody's Investors Service, Inc. (or such higher issuer credit rating as may be specified by any of these credit rating agencies from time to time as the lowest investment grade credit rating), or is an equivalent rating from another agency that has been notified to the licensee by the Authority as of comparable standing for the purposes of Standard Special Condition A38 (Credit Rating of the Licensee) and:
 - (i) is on review for possible downgrade; or
 - (ii) is on Credit Watch or Rating Watch with a negative designation; or, where neither (i) nor (ii) applies:
 - (iii) the rating outlook of the licensee as specified by any credit rating agency referred to in sub-paragraph (c) which at the relevant time has assigned the lower or lowest investment grade issuer credit rating held by the licensee has been changed from stable or positive to negative.
4. Where paragraph 3 applies, the licensee may not without the prior written consent of the Authority (following disclosure of all material facts) transfer, lease, license or lend any sum or sums, asset, right or benefit to any affiliate or related undertaking of the licensee as described or referred to in paragraph 1(b), otherwise than by way of:
 - (a) payment properly due for any goods, services or assets in relation to commitments entered into prior to the date on which the circumstances described in paragraph 3 arise, and which are provided on an arm's length basis and on normal commercial terms;
 - (b) a transfer, lease, licence or loan of any sum or sums, asset, right or benefit on an arm's length basis, on normal commercial terms and where the value of the consideration due in respect of the transaction in question is payable wholly in cash and is paid in full when the transaction is entered into;

- (c) repayment of, or payment of interest on, a loan not prohibited by paragraph 1(a) and which was contracted prior to the date on which the circumstances in paragraph 3 arise, provided that such payment is not made earlier than the original due date for payment in accordance with its terms; and
- (d) payments for group corporation tax relief or for the surrender of Advance Corporation Tax calculated on a basis not exceeding the value of the benefit received, provided that the payments are not made before the date on which the amounts of tax thereby relieved would otherwise have been due.

5. In this condition:

“cross-default obligation” means a term of any agreement or arrangement whereby the licensee’s liability to pay or repay any debt or other sum arises or is increased or accelerated or is capable of arising, of increasing or of being accelerated by reason of a default (howsoever such default may be described or defined) by any person other than the licensee, unless:

- (i) that liability can arise only as the result of a default by a subsidiary of the licensee;
- (ii) the licensee holds a majority of the voting rights in that subsidiary and has the right to appoint or remove a majority of its board of directors; and
- (iii) that subsidiary carries on business only for a purpose within paragraphs 1(a), 1(b), 1(c) or 1(d) of the definition of permitted purpose set out in Standard Special Condition A32 (Definition of Permitted Purpose).

“indebtedness” means all liabilities now or hereafter due, owing or incurred, whether actual or contingent, whether solely or jointly with any other person and whether as principal or surety, together with any interest accruing thereon and all costs, charges, penalties and expenses incurred in connection therewith.

“investment grade” has the meaning given in paragraph 2 of Standard Special Condition A38 (Credit Rating of the Licensee).

“issuer credit rating” has the meaning given in paragraph 2 of Standard Special Condition A38 (Credit Rating of the Licensee).

6. Where the holder of this licence owns one or more relevant gas transporters, the licences for which are held in a single legal entity, references in this condition to **“licensee”** shall mean this legal entity.

Gas Act, Section 9. General Powers 7 Duties

- (2) It shall also be the duty of a gas transporter to avoid any undue preference or undue discrimination
- (a) In the connection of premises or a pipeline system operated by an authorised transporter to any pipe-line system operated by him; and
 - (b) In the terms of which he undertakes the conveyance of gas by means of such a system