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Your Ref: Ofgem doc 212/06

Dear Sonia

**National Grid Grain LNG Ltd application for exemption from Section 19D of the Gas Act 1986: consultation**

energywatch welcomes the opportunity to respond to the issues raised by this consultation. This response is non-confidential and we are happy for it to be published on the Ofgem website.

Consumers will welcome any project that provides further improvements to security of gas supply and creates both increased capacity and enhances the deliverability of gas. With Great Britain now a net importer of gas, it is important to consumers that security of supply is maximised within the context of open and effective competitive markets, which should keep the ultimate costs of gas to them as low as possible. Consumers, particularly the most vulnerable, expect a safe, secure and reliable gas supply delivered on an economic and efficient basis.

We would be concerned if Grain LNG (GLNG) sought not to proceed with the Grain 3 project without obtaining a fully unconditional regulated third party access (rTPA) exemption. While we appreciate that GLNG requires regulatory certainty for itself and prospective capacity holders that will guarantee use of an upgraded facility, the case should not be presented as one of a conditional investment. A robust regime for use of such facilities should always seek to prevent the hoarding of access rights. The trading of unused rights in an open market should also be a feature of such a regime. We note that Ofgem has been provided with confidential information which may set out the case for GLNG's conditional stance. All consumers will rely on Ofgem to make the appropriate judgements regarding GLNG's case in the light of its primary statutory duty to them to protect their interests before reaching its final view on this application.

We believe that, despite the case made by GLNG, there should be no unconditional granting of an exemption. GLNG must demonstrate that there will be appropriate mechanisms in place to prevent the hoarding of capacity and, if a capacity holder fails to use its allocation, there will be secondary trading of unallocated capacity. We note that Ofgem currently undertakes market monitoring activity at Grain phase 1 and we believe that, in order to provide assurance to the market that capacity is

being effectively utilised at Grain 3, Ofgem should only agree to the exemption if it undertakes similar monitoring at Grain 3, in addition to firm assurances obtained from GLNG that it will publish sufficient data to the market to allow competition for underutilised capacity. The final decision on the exemption application should only occur once the primary capacity holders at Grain 3 are clearly identified. We welcome and agree with Ofgem's intention to publish a guidance note on effective anti-hoarding arrangements at LNG importation terminals in due course.

As Ofgem will be aware, energywatch has raised a UNC modification (UNC104) which seeks to improve information transparency at all LNG importation facilities regarding the levels of gas held in store. UNC104 is currently with the Authority for decision. We believe that publication of this data provides benefits by ensuring that capacity is not hoarded or underutilised at such facilities, in addition to any regulatory market monitoring or data already published about these facilities and provided to interested parties, as noted by Ofgem in the document. We would like to see this level of openness extended to Grain 3 in due time. Information transparency is a key component of open and effective competitive markets and we believe that any measures which enhance market information without adversely impacting on necessary commercial confidentiality should be implemented.

We note the analysis provided by GLNG about the competitive impact if Grain 3 proceeded with different capacity holders and Ofgem's own analysis. We accept that the overall competitive impact as portrayed is low. However, the competitive impact is measured in terms of capacity rather than deliverable gas supply which may be adversely affected by a number of factors, such as below standard gas quality or unexpected outages at other significant sources. In those circumstances, gas from LNG importation facilities becomes a significant source in its own right and should be subject to an effective regime to prevent underutilisation of facilities by existing capacity holders. We note that the analysis also highlights the potential for increased market concentration in the hands of certain players. Ofgem should seek assurances that capacity will not be concentrated in the hands of a few market players as this will ultimately adversely impact on all consumers in terms of who supplies gas.

We believe, in order to meet condition (c) of the exemption criteria, that GLNG must be seen to be operating at financial arm's length from National Grid Gas (NGG). We note Ofgem's current view that the inter-company loan provided by NGG to GLNG constitutes an arm's length transaction. Ofgem should continue to monitor this aspect of the exemption criteria to provide assurance to third parties that NGG is not unduly influenced as system operator when dealing with Grain 3.

In considering GLNG's application for rTPA exemption, we are mindful that LNG is a global market. Clearly, an increase in LNG importation infrastructure through the building of Grain 3 will provide increased security of supply. However, the existence of facilities does not by itself guarantee that LNG will be delivered to GB markets or consumers when there a number of competing destinations for LNG delivery. While we agree with GLNG that the granting of rTPA exemption could assist with more delivery of LNG to GB, Ofgem should be mindful that this should occur in the context of adequate and appropriate protection of consumers and open and effective use of the facilities.

Therefore, an unconditional rTPA exemption without robust market monitoring or a volunteered open regime for capacity use – information provision, anti-hoarding measures and secondary trading - is not a balanced way in which to develop use of Grain 3. We agree that enhanced LNG facilities help to diversify the gas supply base and would enhance security of supply. However, the risk of abuse of capacity holding is also significant and there may be issues in the future around market concentration.

In conclusion, we cannot support Ofgem's initial view that rTPA exemption should be granted to Grain 3, without Ofgem stating clearly that it will undertake effective monitoring, in addition to measures agreed by GLNG to increase transparency around use of the facility and to have in place effective anti-hoarding measures and secondary trading. The proposed length of any exemption period must not only satisfy the desire of GLNG and primary capacity holders at Grain 3 for long-term regulatory certainty but, more importantly, the interests of consumers. Any agreed exemption must not preclude effective regulatory action if circumstances change significantly and the exemption no longer remains appropriate.

Going forward, we will continue to keep these issues under review as and when they are raised, always considering the possible impact on consumers.

We would appreciate being kept informed of the progress of the consultation and any related issues to enable us to comment as the need arises.

If you do wish to discuss our response further please do not hesitate to contact me on 0191 2212072.

Yours sincerely

Carole Pitkeathley  
Head of Regulatory Affairs