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LNG Storage price control - Initial thoughts

Dear Robert,

RWE npower welcomes the opportunity to comment on the issues raised in the above consultation and does so on behalf of all its GB licensed shipper entities and the UK business of RWE Trading GmbH.

Whilst it is to be hoped that competition will develop in the provision of operating margins services to NG NTS (NG) in the short to medium term, and Ofgem are right to encourage NG to establish a transparent and robust process for competition by way of a licence condition, we believe that a number of hurdles exist which may hinder development of effective competition in that timeframe.

Provision of an operating margins service is heavily reliant on a shipper being able to demonstrate that gas will physically be made available (in some cases at specific points on the system) if and when required, which can make it hard for a non storage provider to compete. Even if non storage providers are able to overcome this hurdle it is then difficult for them to price the optionality associated with providing an operating margins service (or price it at a level which is likely to be of interest to NG) because of uncertainty about the spark spread and the volatility of forward gas and power markets. Consequently provision of an operating margins service tends to favour storage providers and as commercial LRS and MRS storage providers know the regulated cost to NG of buying those services from National Grid LNG they are able to price their own services at or close to those regulated prices.

As effective competition may not develop by April 2009 we think it would be sensible to set price caps for the full term of NG's price control. However, NG should be allowed to apply for these caps to be disapplied once they are able to demonstrate effective competition has been achieved, which is a similar approach to that adopted for gas prepayment meter provision. Price caps are the most appropriate form of control in our opinion as the cost structure of National Grid LNG's storage facilities should be easier for Ofgem to form a reliable opinion on than the extent of the operating margins service required and the amount of the revenue needed to fund such a service.

We believe that when setting LNG price caps it is appropriate for Ofgem to make allowances for ongoing operating costs and short term capital expenditure required to maintain the facilities while considering likely revenues from commercial storage activities. Over the last few years demand for LNG storage has been strong and as

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a consequence commercial revenues are likely to have exceeded those assumed in 2002 when the price caps were last set. With the benefit of hindsight therefore previous LNG price caps may have been set too high and this should be bourne in mind when assessing the appropriateness of the future opex and capex requirements needed to provide an operating margins service. We believe Ofgem should assume that revenues from commercial storage activities will continue to be strong when setting future LNG price caps, at least for the next two years.

As regards services to the Scottish Independent Undertakings, whilst we recognise that including capex relating to the continuance of the associated tanker loading facilities would make LNG price caps more cost reflective, we think it would be a dangerous precedent to take steps that would result in NG being remunerated twice for this investment. We do not believe that by setting LNG price caps lower than they should be effective competition will be significantly less likely to develop bearing in mind other hurdles that exist and the fact that competing MRS and LRS storage facilities should be able to offer lower prices than SRS storage facilities in most cases.

Should you wish to discuss our response in more detail please do not hesitate to contact me.

Yours sincerely,

Steve Rose
Economic Regulation

Sent by e-mail and therefore not signed