Gas shippers, gas transporters
and other interested parties

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Date: 17 August 2010

Dear Colleagues

**National Grid Liquefied Natural Gas facilities price control**

National Grid (NG) owns three liquefied natural gas (LNG) facilities that provide a combination of commercial and regulated services; these are Avonmouth, Glenmavis and Partington. All three of these supply operating margins (OM) services to National Grid Gas (NGG). In addition, Glenmavis supplies LNG by tanker to Scotia Gas Networks to serve the needs of the Scottish Independent Undertakings[1] (SIUs); and Avonmouth, has in the past provided Constrained LNG[2]. All of these services are provided at prices regulated by Special Licence Condition C3 (these prices are referred to as the "C3 prices" in the remainder of this letter) of the gas transporter's licence.

These regulated prices were last reviewed in 2008[3]. Since 2008, there have been a number of significant changes affecting the NG LNG business. As a result of a change in OM requirements by NGG, NG LNG chose to close its facility at Dynevor Arms, which had previously being supplying OM services in South Wales. At the same time, NGG was looking to introduce contestability into the provision of OM services (as it is obliged to do under Special Licence Condition C25). Following the tender process for 2010/11 OM requirements, Ofgem suspended the application of the C3 prices for non-locational, orderly rundown and locational North services, on the basis that we had assessed competition for these services to have been effective[4]. In 2009, NG LNG offered tenders for long term commercial storage at its facilities, but market demand for these services was very weak. Additionally, there has been a significant tailing off of demand for the annual commercial storage product. NG LNG therefore initiated a review of the long-term viability of Avonmouth, Glenmavis and Partington[5]. Following this review, NG LNG has indicated that it may close the Partington facility in the future.

In light of the above developments, we have been approached by NG LNG to reconsider the level of the C3 prices, as it considers that the facilities are no longer commercially viable at the current price levels. We have agreed to review the C3 prices and this letter sets out our initial thoughts on the review. In order to have determined the applicable C3 prices for the next OM tender exercise in February 2011, NG LNG needs to receive final proposals from Ofgem by late December 2010 (this timeline assumes their acceptance).

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[1] These constitute four remote towns in Scotland which are not on the main grids. They are supplied with LNG which is delivered by road tanker.
[2] Constrained LNG is a geographic service to support the National Transmission System (NTS) in the resolution of local constraints. NGG NTS provide discounts to shippers prepared to book such LNG storage capacity.
[3] "LNG Storage price control – Final proposals", Ofgem ref 298/07, 19 December 2007
[4] "Operational Margins (OM) Contestability", Ofgem, 18 February 2010
[5] LNG Storage Strategic Review Announcements – 04/11/08, 18/12/09, 26/05/10

## Scope, form, and duration of control

*Scope of control*

In our initial discussions on the review of C3 prices, NG LNG has raised some significant issues, which will need further consideration. These issues include the prospect of bringing LNG assets at Avonmouth and Glenmavis under the remit of the main Transmission Price Control and the potential need for significant future investment in the long-term development of the Glenmavis facility.

In view of the need to complete our review of C3 prices by December 2010, we have decided not to address these particular issues as part of the review. However, we would welcome the input of interested parties on these matters, as they are likely to form part of the debate in the forthcoming transmission price control review. Our initial view is that the scope of the review should be limited to the funding required to contribute to the facilities' continued provision of the regulated services, until suitable alternatives can be found.

*Form of control*

The existing review operates by comparing the expected costs and revenues for all services, and then adjusting the scale of charges for the regulated services so that the total costs and revenues balance. The regulated prices, defined by the "price cap[6]" methodology, set an upper limit on the prices that can be charged by regulated facilities and has been used for this service since it became regulated.

In recent years, the fall in regulated bookings and lack of demand from commercial services has reduced the revenue earned by the regulated facilities and it appears that the costs of these facilities are no longer being covered. An alternative regulatory approach would be to establish a revenue cap, where NG LNG is allowed to recover a target level of revenue, irrespective of the volume of capacity sold. Our previous consideration of this matter have suggested a price cap is more appropriate for this control.

We would welcome respondents' views on the matter.

*Duration of control*

The existing control was set to last until 2012, when it was expected that a new control would be established to coincide with the timing of the transmission price control review. As previously mentioned, there have been a number of significant developments since then that we consider merit a review of the prices set by the control.

The existing transmission price control review is being rolled over until 2013[7]. This is principally to allow implementation of the new sustainable network regulation framework established by our RPI-X@20 project. With this in mind, our current position is that any findings from our review of the LNG Price Control should last until 2013, and that a new control should be developed concurrent with the transmission price control.

For the avoidance of doubt, this should not be seen to prejudge our view on whether these assets would fall under the remit of the main transmission price control. It should also be noted that any new control in 2013 would be expected to be based on the principles of the RPI-X@20 project outcomes[8].

[6] Although denoted as a price cap, this represents a minimum price for the services, as the licence allows NG LNG to charge the greater of the regulated price or the price it has been able to secure for commercial services
[7] "Transmission Price Control 4 – Rollover (2012/12): Scope decision and consultation", Ofgem ref 78/10, 30 June 2010
[8] "Regulating energy networks for the future: RPI-X@20 Recommendations", Ofgem ref 91/10, 26 July 2010



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**Next steps**

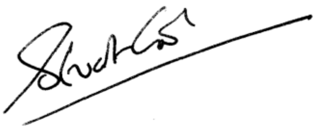
In order to have determined the applicable C3 prices for the next OM tender exercise in February 2011, NG LNG needs to receive final proposals from Ofgem by late December 2010 (this timeline assumes their acceptance). We expect to publish an initial proposals document in early October 2010. Ahead of initial proposals, we will be reviewing the historic and projected costs and revenues in order to form a view on the appropriate funding arrangements. Because of the compressed timescale for this review, we would welcome responses to this letter by 17 September 2010.

Please submit responses both electronically (to the email address below) and in writing. Please put any confidential material in the appendices to your response.

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

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

If you have any comments or questions on this letter, please contact Paul O'Donovan on +44 20 7901 7414 or gas.transmissionresponse@ofgem.gov.uk in the first instance.



**Stuart Cook**
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