

Mr Stuart Cook
Senior Partner – Transmission and Governance
OFGEM
9 Millbank
London

SW1P 3GE

Chris Train
Director, Network Operations

chris.train@uk.ngrid.com
Direct tel +44 (0)1926 655539
Direct fax +44 (0)1926 656563
Mobile +44 (0)7836335778

www.nationalgrid.com

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Dear Stuart

National Grid Liquefied Natural Gas facilities price control

Thank you for the opportunity to respond to your initial open letter regarding Ofgem's intention to conduct a 'National Grid Liquefied Natural Gas' (NGLNGS) facilities price control this year. This response is written on behalf of National Grid plc's NTS business (National Grid NTS) as the owner and operator of the GB Gas National Transmission System.

National Grid Gas purchases Operating Margins (OM) on behalf of the market on an annual basis in line with both the requirements of section K of the UNC and obligations described in the National Grid Gas Safety Case (the Safety Case).

At the last Transmission Price Control Review, National Grid NTS accepted Special Licence Condition C25, which required us to "...use reasonable endeavours to promote competition in the provision of Operating Margins ("OM") services..." A significant amount of work has been completed in this regard, including successful engagement with the industry via three consultations, a UNC modification proposal, a change to the Safety Case and a range of bilateral meetings, all with the aim of ensuring, as far as possible, that barriers to participation are removed and that interested parties were able to contribute to the development of the service provision.

National Grid NTS therefore welcomes this review into the mechanism and level of the existing prices received by NGLNGS in providing OM services as set out within special condition C3 of the Gas Transporter Licence (*Restriction of prices for liquefied Natural Gas (LNG) Storage Services*). We believe this consultation has the potential to better facilitate the licence objectives of National Grid NTS by building on the existing contestability work to date which has already resulted in the partial suspension of C3 prices during 2010/11.

Scope and Control

Your letter of the 17th August 2010 indicated that your initial discussions with NGLNGS raised some significant issues which included the prospect of bringing NGLNGS assets under the remit of the main Transmission Price Control, but concluded the review should be limited to the funding required to contribute to the facilities continued provision of the regulated services.

National Grid NTS supports the requirement for an immediate review and in particular Ofgem's stated objective to have concluded the review by the end of the year prior to the tender for OM services in February 2011. Through the C25 contestability process, providers indicated that any pricing uncertainty of NGLNGS has the potential to impact the level of competition in the tender. This in turn has a knock on effect on the ability for National Grid NTS to create a risk framework in which it would be possible to place an incentive structure around the procurement of this service.

Form of Control

Your letter of the 17th August also raises the question around the potential form of regulation and invites views on whether or not the existing regulatory funding mechanism of a “price cap” (Derived 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) or a ‘revenue cap’ would be more appropriate.

National Grid NTS believes that a criteria for assessment (amongst others) against which regulated mechanism is most appropriate should be based on the principles of whether or not it better facilitates an open and competitive market over the period of the requirement.

Namely the chosen regulatory mechanism should;

1. **Not undermine the development of a competitive market during any interim arrangements.** For example, in the scenario that National Grid NTS becomes the only customer of an NG LNGS site, the short-term economic solution for National Grid NTS could be to book an entire site for OM provision if the price structure created a high marginal price if the site is required but a low incremental cost of any additional booking when compared to the market.
2. **Recognise the value of the elements of the OM service provision.** In its most basic form, National Grid NTS’s requirement is to secure an option from the market to deliver additional gas onto the NTS when an OM event occurs (as defined within the safety case). Depending on the type of OM event; the time over which this gas needs to be delivered (i.e. the site’s space to deliverability ratio) and/or the requirement to secure the rights to deliver the gas is different. The associated market value therefore is driven by how shippers value these elements of the service within their own energy balancing portfolio, which in turn drives facility investment in these desired characteristics.
3. **Recognise the value of the option availability.** National Grid NTS currently has pre-emption rights over storage space and/or deliverability rights in NGLNGS sites. The value of this right is not currently represented in that it enables National Grid NTS to conduct short-term tenders on a yearly basis for the whole requirement without the need for securing an element of longer-term contracts to guarantee sufficient availability in the market.

Should you wish to discuss any aspect of this letter in more detail please contact Andrew Malins (Andrew.Malins@uk.ngrid.com, +44 1926 653220) and we look forward to the opportunity of responding in more detail to Ofgem’s initial consultation due in early October.

Yours sincerely



Chris Train
Network Operations Director