



Gas transporters, gas shippers,
industry participants and
consumer representatives

*Promoting choice and value for
all gas and electricity customers*

Your Ref:
Our Ref:
Direct Dial: 020 7901 7487
Email: ian.marlee@ofgem.gov.uk

Date: 29 November 2010

Dear Colleague,

Operating Margins (OM) Contestability

As part of the Transmission Price Control Review TPCR4, National Grid Gas (NGG) National Transmission System (NTS) accepted Special Condition C25 which required it to use reasonable endeavours to promote competition in the provision of Operating Margins (OM) services by 1 April 2009. The purpose of this condition was to provide a framework for NGG NTS to hold tenders for contracts for the services it needs, thereby allowing competition to develop. It was intended that if the terms of this licence condition were met, then NG LNG storage facilities should be able to tender on the same basis as other potential OM providers¹. Further, it was intended that once competition was established, Ofgem should be in a position to remove the current price cap for the provision of OM services as specified in Special Condition C3 of NGG NTS's licence (referred to in this letter as the "C3 prices").

During the course of its consultations on its SO incentive scheme for 2010/11, National Grid raised concerns that the market for OM provision was not homogenous². As a result of these concerns, a modification to Special Condition C3 was made on 18 February 2010 to clarify that Ofgem's power to direct the suspension of the C3 prices could be used for individual OM requirement types³.

In December 2009 we issued a letter to the industry⁴ (referred to in this letter as the "December 2009 open letter") setting out that we were minded to suspend the C3 prices for the relevant period of OM provision provided that we judged the tender process to have been effective for the OM requirement type and setting out the criterion on which we would make this judgment. Based on the criterion set out in the December 2009 open letter we directed the suspension of the application of the C3 prices for Locational North, Orderly Rundown and Non-locational services with effect from 06:00 1 May 2010 to 06:00 1 May 2011⁵.

¹ At present, the prices that non NG LNG OM providers offer into the tender are constrained to competitive levels by NG LNG in its role as the OM supplier of last resort. Therefore, in order for NG LNG to be able to "tender on the same basis" as other potential OM providers, NG LNG should face effective competitive constraints from non NG LNG OM providers such that the prices it offers into the tender are also constrained to competitive levels.

² The individual requirement types are Supply Loss, Orderly Rundown, Locational North, Locational Scotland, Locational West, Locational Wales, Locational South and Non-locational.

³ [http://www.ofgem.gov.uk/Networks/Trans/GasTransPolicy/LNGPriceControl/Documents1/Direction%20to%20Modify%20Special%20Condition%20C3_170210\(1\).pdf](http://www.ofgem.gov.uk/Networks/Trans/GasTransPolicy/LNGPriceControl/Documents1/Direction%20to%20Modify%20Special%20Condition%20C3_170210(1).pdf)

⁴ http://www.ofgem.gov.uk/Networks/Trans/GasTransPolicy/LNGPriceControl/Documents1/OM%20Contestability_211209_FINAL.pdf

⁵ See our decision letter of 18 February (hereafter the "February 2010 decision letter")

[http://www.ofgem.gov.uk/Networks/Trans/GasTransPolicy/LNGPriceControl/Documents1/OM_Contestability_18_February_2010%20\(sig\).pdf](http://www.ofgem.gov.uk/Networks/Trans/GasTransPolicy/LNGPriceControl/Documents1/OM_Contestability_18_February_2010%20(sig).pdf)

It is also worth noting that the provision of Operating Margins by reducing demand from the NTS and/or increasing supply on to the NTS was subject to a successful revision of the National Grid Transmission Safety Case that was deemed satisfactory by the HSE in February 2010. Therefore the provision of OM services to NGG NTS is open to a full range of facilities. We would encourage all relevant parties to consider tendering for these services.

The current C3 prices were set during the LNG price control of 2008 and were set to endure until the earlier of 2012 or the establishment of contestability. Following an approach by NG LNG, and the suspension of the C3 prices for some requirements in 2010/11, Ofgem is currently reviewing C3 prices and has recently published its Initial Proposals⁶.

OM Contestability from May 2011 onwards

NGG NTS is about to start the tender process for the procurement of OM gas to meet the requirement for OM provision from May 2011. In line with our previous view, and notwithstanding the current review of the C3 prices, we are minded to suspend the C3 prices for the relevant period of OM provision where we judge competition in the provision of OM services for the OM requirement type to have been effective.

In order to judge whether competition is effective in the provision of OM services, we propose the key criterion to be whether NGG NTS can purchase the complete volume of an OM requirement type from providers other than NG LNG storage. As set out in our February 2010 decision letter, in cases where only a small number of non NG LNG providers are available to meet an OM requirement we shall need to consider factors beyond our key criterion, for example, the range of tenders received and the level of prices offered. Where NGG NTS is unable to purchase the complete volume of an OM requirement type from providers other than NG LNG, we consider that the price at which NGG NTS procures volumes from the NGG LNG storage facilities will still need to be regulated given that these costs are passed directly through to shippers.

Responses

We would welcome views or comments from interested parties in respect of how we consider whether competition has been effective. If you wish to make verbal comments, contact details can be found at the end of this letter. Any written comments should be sent to:

Philippa Pickford
Ofgem
9 Millbank
London
SW1P 3GE
Philippa.pickford@ofgem.gov.uk

If you reply to us in writing, your response may be published on Ofgem's website www.ofgem.gov.uk and placed in its library unless you ask us to keep it confidential. Ofgem will 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.

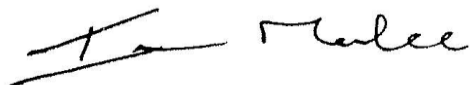
If you do wish your response to remain confidential, please clearly mark the document/s to that effect and give the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Please put any confidential material in the

⁶<http://www.ofgem.gov.uk/Networks/Trans/GasTransPolicy/LNGPriceControl/Documents1/LNGPC%202010%20Initial%20Proposals.pdf>

appendices to your responses. We would welcome responses by **Tuesday 4 January 2011**.

If you have any queries or comments on this letter, please contact Philippa Pickford (07786 197346) or Timothy Wyndham (020 7901 7146) in the first instance.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ian Marlee', with a horizontal line drawn underneath the name.

Ian Marlee
Partner, GB Markets