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National Gas Emergency Service - 0800 111 999* (24hrs)
*calls will be recorded and may be monitored

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23 September 2011

Dear Rachel

Consultation on Glenmavis Liquefied Natural Gas facility

National Grid welcomes the opportunity to respond to this consultation. This response is sent on behalf of National Grid Gas plc (NGG) in our position as owner and operator of the National Transmission System (NTS) in Great Britain. We understand that a separate response will be sent from National Grid LNG Storage given our separate roles in this issue.

We support the conclusion made in the consultation that security of supply to the Scottish Independent Undertakings (SIUs) should be ensured for winter 2011/12 and have always agreed to passing the extra costs to Scotland Gas Networks plc ("SGN") of supplying these customers through Special Condition C26 of our gas transporter licence in respect of the NTS ("the licence") as appropriate. This is because, as these costs are fixed "ex ante" in the licence following each gas distribution price control, our transmission charges can always be set to accommodate them on a direct "cost pass-through" basis which ensures that we are held whole throughout the process.

The NTS charges that recover SGN's SIU costs are the NTS TO entry commodity charge and the NTS TO exit capacity charge. The commodity charge applies from April to March with the option to update this if necessary in October. In contrast, exit capacity charges[1] apply from October to September and there is no provision to update the charge within-year once set[2]. When considering changes to either of these charges, we give an estimate of such changes in an "indicative notice" that is published 150 days prior to implementation. Subsequently, a "final notice" is published to confirm the actual price change two months prior to implementation[3].

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[1] Entry Capacity charges are sold by way of auctions and so are not relevant to this topic

[2] This issue was the subject of a consultation paper published in October 2008 (NTS GCM 13) outlining possible options for addressing Exit Price volatility due to the misalignment of the Gas Year (i.e. October to September) which is used when setting Exit Capacity charges and the Formula Year (April to March) which defines the allowed revenue under the licence. It sought to gauge industry support for a change to the current Exit Price setting arrangements but the industry view, which was upheld in the decision document in February 2009 (NTS GCM 13R), was that no change should be made to the charge-setting process.

[3] See The Notice of Gas Transmission Transportation Charges effective from 1 October 2011

Against this background, the charges to apply from 1 October 2011 (both entry commodity and exit capacity) were set and communicated to shippers on 1st August 2011. Unfortunately, since this was prior to the publication of the consultation, albeit by a matter of days, the charges could not take into account the proposed changes to SIU costs. Nevertheless, it is important to consider the charging implications for our customers of the proposal to increase the $SGNACP_t$ term (part of the $ACPS_t$ term shown below) for 2011/12 from £5.4m to £15.1m (both in 05/06 prices) due to the obligations placed on us by other conditions within our licence.

Specifically, paragraph 6 of Special Condition C26 sets out that (emphasis in bold is by National Grid):

> *The licensee **shall** recover an amount equal to the aggregate of:*
>
> > *(i) the sum of the amounts calculated pursuant to paragraph 2 ($BPDE_t$ + $BPDADJ_t$); and*
> >
> > *(ii) the additional costs payments made to the relevant DN operators under paragraph 5 (ACPSt + ACPWt)*
>
> *from shippers **in the relevant formula year to which such payments relate**.*

This means that in order to apply the proposed changes to the licence, assuming we were not forecasting to over-recover our TO allowed revenue, a further revision to our transmission charges would be required, so that the additional incremental payments to SGN could be recovered in the same formula year as the payments relate (i.e. before April 2012). We have considered the practicalities of this; the impacts it would have on shippers; and, having done this, proposed an alternative approach which would be less disruptive to shippers during 2011/12.

Practical implementation of proposed changes

Given the timing of the consultation, we would not be able to apply the usual notice periods for making these changes. Specifically, the indicative notice would need to be reduced from 150 days to, we estimate, less than 90 days so that the price change would take effect during 2011/12. The exact reduction in notice would depend on when the Section 23 notice was published. Aside from any change to the notice periods, we are also to use reasonable endeavours to only change commodity prices in April and October and exit capacity prices in October. However, the licence allows for the Authority to direct changes to be made at other times[4]. Against this background, we would welcome Ofgem's thoughts on the timing of further price changes to implement the proposed licence amendments and whether or not it intends to provide a direction to use alternative dates. We believe a direction would be helpful to underpin the unusual timings and scope of the changes; not least so as to allow all shippers to fully understand the timescales involved.

Impact on shippers of proposed changes

Assuming changes to charges were made within 2011/12, we would envisage that the resulting increase to the entry commodity charge would span only one or two months at the end of this formula year (2011/12) and the change to exit capacity charges would apply until 1 October 2012. We

[4] See Paragraph 2 of Standard Special Condition A4. Charging - General

estimate the increase in entry commodity charges would be about 0.0030 p/kWh (13%); and the change to exit charges, which vary by location, would be about 0.0018 p/peak day/kWh (representing an median increase of 13% with some offtakes unaffected but others seeing an increase of up to 1700%). Since the exit capacity charges would not be updated until 1 October 2012, there is also a risk that the change to exit prices at this time would be greater than they would otherwise have been. Against this background, we believe that such a change would be unwelcome to shippers due to the volatility it would introduce both within 2011/12 (with limited notice) and within 2012/13.

Alternative approach

We consider that a preferable solution would be for the extra cost arising from the SIU supply (£9.7m in 05/06 prices) to be inserted into the 2012/13 column of Table 1 in Special Condition C26 (rather than the 2011/12 column) together with any efficient financing costs. This would allow SGN to recover their SIU costs from consumers in a manner which would spread the increase in charges to shippers over a more appropriate time period. We appreciate that this solution could result in a short term under-recovery for SGN but also note that the licence provides scope for flexibility in the timings of payments made to SGN in a given year. However, to the extent that such delays in cost recovery may be inevitable, the onus must be on the company incurring the additional costs (as opposed to shippers) to take responsibility as they have the greatest opportunity to manage these costs.

We believe it may have been helpful had the consultation elaborated further on the implications of the proposal on transmission charges as this may have allowed interested parties to better understand and comment on the full impact of the proposed licence change. However, it is unclear whether Ofgem believes further price changes should be made during 2011/12 to accommodate the proposed additional payments to SGN. If Ofgem does not consider a further price change is necessary but amends the licence to require us to make additional payments to SGN, this would represent a significant departure from previous regulatory practice, as we would in effect be acting as a "bank" for other gas network owners. We do not believe this would be appropriate notwithstanding the fact that the licence currently does not envisage such a solution.

Finally, we have no objection to the proposed amendments to paragraph 8 of the Special Condition C26 and agree that the definition of “independent system” (within C26 only) is improved by including a reference to LNG as well as LPG.

If you wish to discuss any of the issues discussed in this response please contact Alex Haffner on 01926 65 5838, or at alex.haffner@uk.ngrid.com, in the first instance.

Yours sincerely,

[by email – hard copy to follow in the post]

Paul Whittaker
UK Director of Regulation