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Dear Francesca

Consultation on the regulated TPA regime for LNG facilities in GB

Background

National Grid Grain LNG Ltd ("GLNG") welcomes the opportunity to respond to this consultation.

GLNG is a wholly owned subsidiary of National Grid plc and was set up in June 2002 to convert the then existing peak shaving storage assets at the Isle of Grain in Kent into the UK's first modern LNG importation terminal. First commissioned in 2005, the Grain LNG terminal initially (Phase 1) had the capacity to receive and process up to 3.3 million tonnes of LNG (4.4 billion cubic metres of gas) per annum, equivalent to 13 million cubic metres (140GWh/d) of gas per day.

Expansion of the Grain LNG terminal, to triple capacity to 9.8 million tonnes per annum (12 per cent of UK gas demand), was completed in December 2008 (Phase 2) with three of the biggest above ground full containment LNG storage tanks in the world. In December 2010, further expansion came on-line (Phase 3), giving the site an additional 5 million tonnes of capacity (taking the total capacity to the equivalent of around 20% of GB gas demand) through an additional storage tank and second jetty, able to receive the world's largest LNG carrier - the Q-Max.

Primary capacity at the Grain LNG terminal has been auctioned through open season processes and is contracted to our customers who determine the actual LNG throughput. Future incremental capacity is currently on offer at the terminal and an open season process is ongoing for a further expansion (i.e. Grain Phase 4). The timescales and amount of capacity will depend on customer requirements and rely on an exemption from third party access being granted, consistent with the other phases of the terminal. However, additional capacity could be available from winter 2016-17.

Introduction

As an existing and exempt LNG facility (all 3 phases were awarded an exemption under Section 19C of the Gas Act), we believe that we are compliant with both Regulation (EC) No 715/2009 ("the Regulation") and the new Electricity and Gas (Internal Markets) Regulations 2011 ("the new legislation") which transpose Directive 2009/73/EC ("the Directive") into GB legislation. Unless otherwise explicitly stated, the views contained in this response apply in general to the rTPA regime to which the majority of the consultation refers.

We are broadly supportive of the preliminary views put forward by Ofgem in this consultation on how the provisions relating to third party access (TPA) to LNG facilities in GB should be interpreted. In Chapter 3 on "Transparency and information provision to the market" we agree that there are potential benefits to the market if facilities were to endeavour, where possible, to make available all appropriate information regarding their operations. However, we believe that the priority must first be to ensure

that the provisions of Section 11C of the Gas Act on "Restrictions on disclosure of information by facility owners" are met in full. In Chapter 4 on "Governance, monitoring and enforcement" we believe that the requirement under the new legislation (Section 11B of the Gas Act) for owners of LNG facilities to provide to the authority, on request, any information it requires was already a requirement under Section 19DA of the Gas Act before the advent of the new legislation.

We also agree with the majority of Chapter 2 of the consultation on "Capacity allocation mechanisms and congestion management procedures". For instance, we support Ofgem's preliminary views on how the 'maximum capacity' of an LNG facility should be defined (i.e. flexible enough to allow for the complex permutations of the various services available at LNG facilities such as berthing slots, tank capacity and send-out capacity) and that LNG facilities operating under the rTPA regime should consult the market as appropriate before new capacity or services are to be offered.

However, given that under the new legislation (Section 19DB) it will be necessary for the Authority to approve the capacity allocation mechanisms available at a facility before an exemption can be granted, it is the remaining contents of Chapter 2 of the consultation that we intend to focus on.

Choice of allocation mechanism

Whilst we see the benefits that auctions can deliver under an rTPA regime in terms of transparency and price-discovery, we welcome the view outlined in paragraph 2.29 that "in the case of new investment, we consider that open season procedures can provide an acceptable alternative to auctions, to ensure a comprehensive market consultation and non-discriminatory allocations". Furthermore, we appreciate the importance of both *Phase 1*, assessment of market appetite for capacity under defined terms through effective communication with potential open season participants and *Phase 2*, the actual mechanics of how capacity is allocated leading to binding agreements between the investor and the users: a simple auction may not be able to address the complexities of capacity sharing over different timeframes for example.

Specifically, under the rTPA regime, we believe that allocating capacity in a manner by which the prospective capacity holder bids what it is willing to pay for the capacity (either by way of an auction or an open season process) may be a sensible approach where regulated and non-regulated terminals sit alongside each other. This is because it reduces the need for regulators to become heavily involved in price setting which could ultimately distort the market. However, we are also of the view that reserve prices are crucial in this approach as terminal owners must reserve the option not to sell capacity in the event that the costs of providing the capacity outweigh the revenue it can deliver. Relatively long term contracts may also be required to give parties the necessary certainty that any investment necessary both at the terminal or upstream are adequately covered.

As mentioned above, an open season process is currently in progress for a further expansion of the Grain LNG terminal (i.e. Grain Phase 4). In the open season process LNG market participants can bid for the right to berth LNG carriers and unload LNG into the facility for temporary storage, prior to re-gasification and delivery of gas into the GB national transmission system. The process is the same as for the previous 3 Phases (for which exemptions have been granted) and is fully compliant with ERGEG's Guidelines for Good Practice on Open Season Procedures (GGPOS).

Contractual congestion and anti-hoarding arrangements

As stated in paragraph 2.38 of the consultation, it is a requirement of the exemptions awarded to LNG terminals in GB to offer unused capacity to the market via UIOLI arrangements or secondary capacity trading. We are strongly of the view that effective anti-hoarding mechanisms are in place at the Grain LNG terminal and that the conditions of our exemption are met in full as a result of our UIOLI provisions. We have not seen any evidence of hoarding, either from Ofgem or any other source, which would counter this view. It may be sensible therefore for regulated terminals to structure their congestion management and anti-hoarding mechanisms in a similar way to those at the Grain LNG terminal and other existing GB LNG terminals to avoid any market distortions:

- At the Grain LNG terminal, effective secondary trading is evidenced by our 6 customers' bi-lateral trading activities with third parties delivering their cargoes via our customers' capacity and into GB. We are not party to the upstream trading activity and our customers would wish their commercial arrangements to be protected in what is a highly competitive LNG market. However, the trade press has reported numerous cargoes to have been delivered by third parties to the GB market through the Grain LNG terminal. In other words, if a third party wishes to deliver a cargo to GB they can do so through tried and tested bi-lateral secondary trading mechanisms which we understand all our customers have in place and have been seen to utilise. Examples of this include the large increase in the supply of Qatari gas to the Grain LNG terminal from both Qatargas and Rasgas and the re-loaded cargoes from the US.

- We do not believe that there is opportunity for one customer to benefit from hoarding capacity at the Grain LNG terminal as there are five other customers competing on the same basis (who would take advantage of any attempt to increase prices artificially through hoarding) and also any such opportunity would be negated by GLNG's own UIOLI mechanism. Post 'Go Live' of Phase 3 (1st December 2010), this mechanism has been enhanced by increasing both the temporary storage capacity (now typically 155,000m^3) and deliverability period (now 10 days) for each berthing slot released under the mechanism. Interest in access to the Grain LNG terminal remains strong with over 50 third parties signing confidentiality agreements with GLNG, allowing them to access the relevant contractual documentation to facilitate UIOLI slots. UIOLI agreements can be signed readily once arrangements (such as credit) are in place so it has not been necessary for any parties to sign contracts in advance.

- We have also developed a commercial inventory system to allow shippers to trade both unused temporary storage capacity and deliverability to promote security of supply by facilitating additional deliveries to GB. We are aware of occasions since the start up of Phase 3 where these capacity transfers have allowed customers to bring larger vessels to GB.

These arrangements are in addition to third parties having the potential to access the GB market via other LNG importation terminals, or the primary capacity holders at such terminals, who would also be looking to acquire cargoes or sell unused capacity. All of our customers across the three existing phases have fully engaged in bringing cargoes to GB, trading with other third parties and engaging in discussions to promote further secondary trading.

In relation to secondary capacity mechanisms, we have been made aware of several products that have been made available by our primary customers across the different phases of development at the Grain LNG terminal. These arrangements require direct interaction of the third party with the capacity holder, GLNG and the port in a way which ensures that this interaction does not impede the subsequent utilisation of the capacity. It is our understanding that third party interest in these products has, to date, been limited. We believe that the main reason why secondary capacity mechanisms are not more widely used is that the bilateral trading activity of primary customers in the upstream market is far more efficient and, being standard practice, is more regularly used.

As a result, we do not necessarily regard this as a large cause for concern and question whether in such a competitive environment anti-hoarding mechanisms are required at all. For example they were deemed un-necessary by the regulatory authorities for LNG terminals operating in the similarly competitive US market.

We would caution against placing more stringent anti-hoarding requirements on regulated terminals as this could detrimentally impact normal and efficient trading activity and limit the ability of primary capacity holders to divert cargoes to GB should market conditions be favourable. Given the importance of LNG importation terminals to UK security and diversity of supply, anything which may appear as regulatory instability and makes the GB market less attractive to LNG suppliers (who may also be primary capacity holders) should be avoided as GB needs to be able to compete with other downstream markets which may be significantly more attractive in terms of price.

Levels of LNG importation terminal utilisation should not necessarily be considered to be due to market access issues but are instead more reflective of supply and demand linked to various world LNG market fundamentals. For instance, the fact that current world regasification capacity is over twice that of world liquefaction capacity implies that average global LNG terminal utilisation should not exceed 50%. The supply contract position of the various terminal users will also be a factor. For example, we are not aware of any long term supply contracts linked to the Grain LNG terminal. Given the prevalence of short term supply arrangements, with the flexibility to move LNG to the most favourable market, there should not be an expectation that LNG will flow to the GB market unless the price is high enough relative to other alternative markets. That said, through GLNG's contractual structure of take-or-pay contracts, capacity holders are incentivised to maximise the utilisation of the capacity and bring cargoes to GB where efficient and economic to do so.

Conclusion

To conclude, we are broadly supportive of the preliminary views raised in the consultation relating to transparency and information provision and to governance, monitoring and enforcement under an rTPA regime.

On capacity allocation mechanisms, whilst we agree that auctions can deliver benefits under an rTPA regime, we believe that open season procedures also provide an efficient means to allocate capacity. Furthermore, in order to mitigate the potential difficulties which could exist in a market composed of both regulated and exempt facilities, we believe that for regulated terminals to allocate capacity on a pay as bid basis may be a sensible approach. This is because it reduces the need for regulators to become heavily involved in price setting which could ultimately distort the market.

The ability of terminal operators to set appropriate reserve prices and not to sell capacity in the event that the costs of providing such capacity would outweigh the revenue it could deliver is also crucial to normal market functioning.

On congestion management procedures, we believe that bilateral trading between primary customers at LNG importation terminals is the most efficient means to ensure that capacity utilisation is optimised. We also note that the utilisation levels at LNG importation terminals are largely driven by global market fundamentals rather than the congestion management procedures in place at each facility.

Finally, on anti-hoarding, we believe that this ability of primary customers to efficiently trade with third parties via their existing secondary trading mechanisms, backed by the UIOLI mechanism in place, gives the Grain LNG terminal a robust anti-hoarding position. It may be sensible therefore for regulated terminals to structure their congestion management and anti-hoarding mechanisms in a similar manner. We do not believe further measures are required or desirable as they could interfere with existing trading mechanisms which in turn could be highly detrimental to efficient access to the market. In the long run this could be perceived by suppliers as regulatory instability which could make the GB market less attractive with a potential impact on GB security of supply.

If you have any questions, or require further information, on this response, please contact Phil Carter in the first instance on 01634 27 3247 or at phil.carter@uk.ngrid.com.

Regards,

[by email]

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National Grid Grain LNG Ltd