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Dear Natasha

Avonmouth LNGS C3 Price Review

National Grid Gas welcomes the opportunity to respond to Ofgem's letter of 25 September 2012. This response is on behalf of National Grid Gas in its capacity as the System Operator for the National Transmission System (NGG NTS). It is not confidential and NGG NTS has no objection to its being published.

Background

Operating Margins (OM) is a service required by the System Operator to manage/arrest significant pressure step changes and associated volume flow rates of gas as a consequence of unplanned high risk, low probability events (e.g. pipe breaks/compressor trips). In these circumstances, if timely response from market actions is insufficient, OM can reduce the risk of an emergency on the gas national transmission system or in the event of an emergency, ensure the safety of users on the system. The availability of adequate volumes and deliverability of OM forms part of the NGG Gas Transporters Safety Case under the Gas Safety (Management) Regulations (GS(M)R). In addition to the OM requirement there is also a need for Transmission Support Services (TSS) which are defined in our Safety Case as a substitute for pipeline capacity at high demands to support a 1 in 20 peak day. One form of TSS is obtained from Constrained LNG (CLNG) held at Avonmouth.

NGG NTS set out its views regarding the future requirement of OM services and TSS in its submissions as part of RIIO-T1 price control (pp 94-105 of our detailed response refers). The NGG NTS requirements have not altered since that submission and we continue to see the need for a long term South-West OM requirement of 110GWh per annum.

Furthermore, since March 2012 we have continued to work with the Industry to identify alternative providers for OM services in the South West that would meet, in part or whole, our needs in relation to fulfilling our statutory duties. The invitation to tender was based on provision of OM for 6 to 8 years to cover the period during which NTS reinforcement could be undertaken to remove the need for an enduring OM and TSS service in this area (as set out in our RIIO-T1 Business Plan).

The results of the above exercise have been discussed with Ofgem staff (16 October 2012). It is clear that NGG NTS will need to continue to rely on the Avonmouth Liquefied Natural Gas Storage (LNGS) facility for the bulk of the OM / CLNG requirement in this part of the system until network reinforcements are completed.

Ofgem's C3 Review

We note Ofgem's proposals regarding the scope and form of the review and these are of some concern to us. Our requirement is for the required level of storage to be available and the gas able to be delivered with a high degree of confidence. Over recent years increasing concerns have been expressed regarding the reliability of the aging plant at Avonmouth and this is a matter of considerable concern to us.

Given that the services provided by Avonmouth LNGS are almost entirely regulated¹ and are required to meet statutory requirements (i.e. the GS(M)R Safety Case) we consider there is a sound case for modifying the form of control to a revenue form rather than a price control.

The price control approach proposed gives Avonmouth LNGS no control over the volume of gas to be held in storage – this will be determined by NGG NTS and our incentive will always be to reduce the cost of these services so far as is possible whilst delivering on our safety obligations. Therefore LNGS will face the risk that alternative providers come forward and offer services below C3 prices resulting in material reductions in stored volumes and hence revenue. However it seems clear following our tender exercise that there will be insufficient alternative providers to entirely remove the need for Avonmouth LNGS until the network is reinforced. In such an environment we are concerned that Avonmouth LNGS would not have the necessary incentive to invest to maintain the levels of availability and deliverability that we require until the site is no longer needed. It seems likely to us that many of the costs faced by Avonmouth will be fixed and independent of the volume of OM/CLNG that we require to be held there and as a result a unit price allowance (C3) based on an uncertain volume seems to be an inherently flawed approach. Given all of the above we consider a revenue restriction could be the more appropriate approach since it could be set to incentivise Avonmouth to manage their costs over the period during which consumers require their service.

We agree with Ofgem regarding the duration of the review – this seems reasonable in the circumstances.

I hope you find these comments helpful. Should you wish to discuss any of the points then please do not hesitate to contact Andy Balkwill (andy.balkwill@nationalgrid.com 01926 65 5988) in the first instance.

Yours sincerely

BY E-MAIL

Chris Train
Network Operations Director

Cc Paul Whittaker

¹ Although the provision of non-regulated services (i.e. those which are not charged at the C3 Price) has not been formally discontinued at Avonmouth, recent trends demonstrate there is limited and declining demand for commercial storage services at Avonmouth on an enduring basis. This was reflected in the low prices bid (close to the reserve price) in the most recent capacity auction and a proportion of the capacity (around 3%) remaining unsold.