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Tuesday, 6th January 2009

Dear Eddie,

RE: NTS GCM 14: Constrained LNG Credits

We believe it is worthwhile to review the current methodology behind the CLNG credits, particularly given that it was last reviewed in 2000.

We agree that it would be more cost-reflective to base the credit on Long Run Marginal Costs (LRMCs), which represent the capital investment cost in additional pipe and / or compression which would be incurred (or saved) by an incremental change in supply or demand respectively at that point. We agree that the methodology should have a nodal (rather than zonal) basis and be based on peak day (rather than average) requirements.

Based on the evidence put forward in the consultation paper, it is clear that the proposed methodology would better incentive National Grid NTS to appropriately consider investment in relation to CLNG costs. Under the current methodology there is the potential for a perverse outcome whereby investment in additional exit capacity results in additional CLNG costs. The proposed methodology ensures that costs reduce as incremental investment is provided as an alternative to CLNG, which is a more logical outcome. Ultimately, this should result in more efficient bookings for the CLNG requirement.

As noted in the consultation paper, this issue has arisen following industry discussions about E.ON UK's proposal for 'Rebates for Entry Points with a Negative LRMC'. We believe this consultation paper highlights further that the current charging methodology does not properly reflect the costs incurred by the Transporter. Due to the current constraint in the 'Transportation' charging model, it could be argued that the system benefits provided through avoided investment (provided by incremental gas flows) are not properly reflected in charges

faced by Users. We recognise that CLNG credits are currently paid to Users as the commitment to flow gas when required is formalised in a specific contract. However, given that the majority of entry points with negative LRMCs are either gas storage sites or LNG importation terminals – and therefore predominantly demand-responsive, we believe that the high level of predictability of flows could be used as a market-based proxy (or indeed a replacement) for the CLNG contract.

It could also be argued that undue preference is currently given to CLNG sites over other entry points with a negative LRMC, which provide the same or similar system benefits (i.e. avoided investment), but are treated in different ways. As such, we believe that National Grid NTS needs to do more work to ensure all entry points with a negative LRMC are treated equally and that the benefits that these points provide are properly reflected in the charging methodology.

I hope that the above comments prove useful. Should you wish to discuss our response further, please do not hesitate to contact me on the number above.

Yours sincerely

Richard Fairholme (by email)
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