Modification proposal:	**Modification Proposal NTS GCM14 'Constrained LNG Credits'**		
Decision:	**The Authority[1] has decided not to veto this proposal[2]**		
Target audience:	**NGG NTS and other interested parties**		
Date of publication:	**17 February 2009**	Implementation Date:	**1 March 2009**

Background to the modification proposal

Constrained Liquefied Natural Gas (CLNG) sites provide support to the National Transportation System (NTS) at the most remote parts of the network during periods of high demand. There are currently two CLNG sites on the NTS, Avonmouth and Dynevor Arms. This will be reduced to one from 2009/10 due to the sale of Dynevor Arms.

Shippers who book 'bundled service'[3] at CLNG sites must maintain a minimum inventory of gas for use during periods of high demand. In return for doing so, Shippers receive a credit from National Grid Gas NTS (NGG NTS), via the LNG facility owner, which recognises the benefits of CLNG as an alternative to NTS reinforcement.

The level of credit is currently set using the exit capacity charge for the exit zone supported by the CLNG site and the average daily requirement for CLNG.

The modification proposal ("the Proposal")

The modification proposal will continue making a credit available to Shippers who book the bundled product at CLNG sites. There are three main elements to how the revised credit will be calculated:

- Charge: The credit would be based on the Long Run Marginal Cost (LRMC) rather than exit charges
- Location: The credit would be based on the LRMC between the National Balancing Point (NBP) and the CLNG site
- The credit would be based on 1-in-20 peak day requirements rather than the average daily requirement

Justification of the modification proposal

NGG NTS considers that GCM14 better achieves the relevant gas transmission transportation charging methodology objectives in that:

- Cost reflectivity is improved by basing the CLNG credit on the LRMC between the NPB and the CLNG site which reflects the avoided costs of investment which CLNG services allow and the actual physical location of the constraint. Furthermore, basing the CLNG credit on peak day requirements reflects when that investment is made i.e. for high demand days.
- Efficiency is promoted as CLNG credits which better reflect costs of alternative infrastructure will allow NGG NTS to make more efficient

[1] The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.
[2] This document also constitutes notice of the reasons for this decision as required by section 38A of the Gas Act 1986.
[3] This bundled service comprises storage injectability, storage space and storage deliverability.

decisions on dealing with constraints between using CLNG and investing. Also sub-optimal decisions will be avoided by removing the anomaly whereby a requirement for a lower number of days of the CLNG service (following additional infrastructure investment) results in increased credit costs to NGG NTS.
- Undue preference is avoided as all Shippers booking the 'bundled storage service' at the CLNG facilities will receive the same credit.
- Competition is promoted by providing appropriate credits to users of CLNG facilities in recognition of the benefits provided through transmission support.

Responses to NTS GCM 14

NGG NTS consulted on the modification proposal between the 27 November 2008 and 6 January 2009. They received five responses all of which supported the proposal.

All respondents agreed with NGG NTS that basing the calculation on LRMC at the constrained node would increase cost reflectivity. First, this was because it would be more cost reflective to base the credit on the LRMC which represents the capital investment cost of investing in additional pipes or compression. Second, basing the credit on the LRMC at the CLNG node is more cost reflective than the exit capacity charge at the zones supported by the CLNG site since the constraint is between the NBP and the CLNG node and any investment needed would therefore be to deal with a constraint located between the NBP and node.

Respondents also agreed that basing the CLNG credit on peak not average requirements should reduce the perverse incentive whereby further investments made by NGG NTS to reduce the number of constraint days may actually increase CLNG credit costs for NGG NTS. They agreed that basing the CLNG credit on peak day requirements better reflects the costs of investment since investment is driven by meeting the 1-in-20 peak day requirements.

One respondent questioned the fairness of the proposals to other entry points with negative LRMCs as it considered these entry points provide similar benefits to the NTS through avoided investment but would be treated differently from CLNG sites.

NGG NTS responded by stating that the only sites it has identified which have negative LRMCs that genuinely result in avoided investment for exit are CLNG sites. It will consider the issue further if data can be presented which provides clear evidence of a consistent benefit from other entry points.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Conclusions Report dated 20 January 2009. The Authority has considered and taken into account the responses to NGG NTS's consultation. The Authority has concluded that:

1. **Implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the Methodology[4]; and;**
2. **Deciding not to veto the proposal is consistent with the Authority's principal objective and statutory duties.**

[4] As set out in Standard Special Condition A5(5) of NGG's Gas Transportation Licence

Reasons for the Authority's decision

SSC A5(5)(a) save in so far as paragraphs (aa) or (d) apply, that compliance with the charging methodology results in charges which reflect the costs incurred by the licensee in its transportation business

CLNG sites can provide benefits to the NTS during high demand periods as they allow for gas to continue to be flowed to remote parts of the NTS when there may be a constraint on the NTS further upstream from the CLNG site. By providing this support NGG NTS does not need to invest as much on the NTS to meet peak day requirements. It is therefore appropriate that users booking the CLNG product receive a benefit, in the form of a credit, for the services that they provide which in turn assists in avoiding investment costs. This credit should be paid where it is economical to flow LNG gas instead of investing in the NTS – the credit should therefore reflect avoided investment in the NTS.

Ofgem agrees that GCM14 would result in greater cost reflectivity of the CLNG credit. First, this is because basing the CLNG credit on peak requirements rather than average daily requirements better reflects the fact that CLNG is more likely to be required during periods of high demand i.e. peak flows. Currently the CLNG credit is based on average daily CLNG requirements. The NGG NTS report included an example whereby if it invested more on the NTS to reduce the likelihood of constraints using an average daily requirement, the total requirement for CLNG, despite being less, may be spread over fewer days which can result in a higher CLNG credit being paid. This is a perverse signal as by investing more to reduce constraints we would expect that the CLNG credit paid, as an alternative to investing, would also decrease. This anomaly is removed by basing the CLNG credit on peak requirements.

Second, basing the CLNG credit on the LRMC better reflects the benefits that CLNG provides through avoided investment. This is because the LRMC reflects better the costs of investing than the exit capacity charge as the latter has an adjustment factor in order for NGG NTS to recover its allowed revenue. Finally, basing the CLNG credit on the location between the NBP and the CLNG site better reflects where on the NTS that the constraint would happen. If CLNG is required in the event of a constraint then gas will still be able to flow between the CLNG site and exit zones supported by the CLNG site – the constraint does not allow gas to flow from the NBP to the CLNG site.

Ofgem considers that GCM14 will further the relevant objective of cost-reflectivity and should allow for NGG NTS to make more optimal decisions on whether to invest more or not on the NTS to reduce constraints vis-à-vis using CLNG, both of which should better protect the interests of consumers.

However, there are some issues which the modification did not address but which we believe need further consideration. Since National Grid own the LNG facilities, it is important to understand whether the effect of the proposal in any way distorts NGG NTS's behaviour in the management of constraints in such a manner which could favour these facilities over and above alternative constraint management solutions. For example, whilst the impact of this proposal may be to reduce NGG NTS's incentive revenue (under its constrained LNG incentive) there may be a net gain to National Grid through the inflationary effect it could have on storage costs at the LNG facility. In this respect, we would want to see written assurances from NGG NTS that the adoption of this proposal is not unduly discriminatory in its impact on services that are direct substitutes for CLNG, eg

shippers providing interruptible services in the vicinity of the constraint. For example, it may be the case that it is more efficient and less costly for NGG NTS to seek to utilise interruptible contracts to manage the costs of constraints as an alternative to using CLNG. In this respect NGG NTS should consider whether the methodology used to determine interruptible discounts is appropriate to ensure that no undue discrimination is taking place.

Finally, in view of the falling system demand due to the current economic climate, it might be prudent for NGG NTS to review its 1-in-20 investment requirements as this might further reduce the payments required for CLNG.

Decision notice

In accordance with Standard Special Condition A5 of NGG NTS's Gas Transportation Licence, the Authority has decided to not to veto modification proposal GCM14: Constrained LNG Credits.

Stuart Cook
Director, Transmission

Signed on behalf of the Authority and authorised for that purpose